PRACTICE GUIDES

Swiss M&A

Second Edition

Contributing Editors
Ueli Studer, Kelsang Tsün and Joanna Long

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Swiss M&A

Practice Guide

Second edition

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Tax Considerations in M&A Transactions

Susanne Schreiber and Cyrill Diefenbacher[1]

Tax framework and recent changes

General tax framework

Corporate income and capital tax

Legal entities are subject to corporate income tax if they are resident (ie, if they are incorporated or effectively managed in Switzerland). Swiss corporate income tax is levied on the worldwide net income of a legal entity, except for foreign real estate and foreign permanent establishments. Depending on the canton and community of incorporation or management, the effective corporate federal, cantonal and communal income tax rate on net profits before tax varies between approximately 12 and 21 per cent.

Swiss tax rules foresee the possibility of carrying forward tax losses and using them against future tax profits during a seven-year period.

Furthermore, Swiss tax-resident legal entities are subject to a capital tax levied annually on the taxable equity, which also varies between cantons and communities.

Withholding tax

A Swiss withholding tax is levied on dividends, including deemed dividends, and certain types of interest deriving from a Swiss source, as well as certain insurance payments paid by Swiss insurance companies. In principle, a flat tax rate of 35 per cent is automatically deducted by the payer (debtor system) and is, if the income is properly reported by the Swiss resident beneficiary, reimbursed through a cash refund or credited against the personal income tax liability. Dividends paid out of qualifying capital contribution reserves are not subject to Swiss withholding tax and are income tax-exempt for Swiss individuals holding the shares as private assets. Non-Swiss resident income beneficiaries principally suffer the withholding tax as a final burden, unless they are eligible for a partial or full refund based on an applicable Swiss double tax treaty. The Swiss

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withholding tax regime may, however, soon be partly remodelled with respect to interest (see 'Contemplated Swiss withholding tax and securities transfer tax reform').

Stamp duties

Issuance stamp duty

The issuance of new share capital as well as any contributions into the reserves of a Swiss corporations made by its direct shareholders are subject to issuance stamp duty, which amounts to 1 per cent of the net contribution received by the company. Benefits received from indirect shareholders are not subject to this duty.

The Stamp Duty Act exempts certain transactions from the issuance stamp duty (eg, the first 1 million Swiss francs received as contributions in connection with the issuance of shares or shareholder contributions of up to 10 million Swiss francs received in the context of a recapitalisation, to the extent that the contribution eliminates losses in the balance sheet).

Securities transfer tax

Transfers of taxable securities (eg, shares or bonds) against consideration and with the involvement of at least one Swiss securities dealer as party or intermediary may be subject to securities transfer tax of 0.15 per cent (Swiss securities) or 0.3 per cent (foreign securities) on the purchase price. The tax is due by the Swiss securities dealer, which pays half of the tax for itself and another half for the counterparty or client that is neither a Swiss securities dealer nor an 'exempt investor' (exempt investors include inter alia Swiss and foreign investment funds, foreign regulated pension funds and life insurers, and listed foreign companies and their foreign consolidated subsidiaries).

It is to be noted that the term 'Swiss securities dealer' comprises not only professional securities traders, banks, brokers, asset managers and the like, but also all Swiss-resident corporate entities whose assets consist, as per the last annual balance sheet, of taxable securities in excess of 10 million Swiss francs. Thus, a Swiss holding company often qualifies as a Swiss securities dealer and as such becomes generally subject to the tax on taxable transfers and needs to take care of the relevant compliance (regular filings of returns, keeping a securities turnover register).

Exceptions apply inter alia in the case of tax-neutral reorganisations, intercompany transfers of at least 20 per cent shareholdings (10 per cent in case of transfers to subsidiaries) or if the transfer forms part of a replacement investment of a qualifying participation of at least 10 per cent of the share capital of another company.

Income tax

All periodic or one-time income is generally taxable for a Swiss-resident individual (worldwide income, except for foreign real estate, permanent establishments or explicit tax-exempt income). Swiss income tax laws include a very beneficial provision that capital gains from the sale of private assets (other than Swiss real estate) are tax-free (subject to certain limitations to avoid abuse (eg, indirect partial liquidation or transposition, qualification of the individual as commercial securities dealer, etc)).

The Federal Act on Tax Reform and AHV Financing

The Federal Act on Tax Reform and AHV (social security) Financing (TRAF) entered into force on 1 January 2020 and had a significant impact on the Swiss tax landscape.

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TRAF repealed the privileged tax regimes, namely holding, mixed and domicile company taxation at the cantonal level, and finance branch and principal companies' taxation at the federal level. As compensation, the new legislation included a provision to avoid over-taxation on untaxed hidden reserves for companies transiting out of a privileged tax regime at cantonal or communal tax level (special rate solution). It further introduced a mandatory OECD-compliant patent-box regime and an optional super-deduction for R&D expenditures. Both instruments were implemented at cantonal level only. A number of the cantons make use of the maximum allowed deduction of 90 per cent for the qualifying income from patents and similar rights (eg, Zurich and Zug). Others implemented more restricted deductions in the range of 10 to 50 per cent (eg, Geneva with a maximum allowed deduction of 10 per cent and Neuchatel with a maximum deduction of 20 per cent). At the same time, most of the cantons significantly lowered their corporate income tax rates and some cantons make use of the possibility under TRAF to reduce the taxable basis on qualifying participations, patents and similar rights and intercompany loans for cantonal capital tax purposes. TRAF also included a notional interest deduction, which, however, is only available in the canton of Zurich.

Further, for Swiss-resident individuals, TRAF leads to a higher taxation on dividends from qualifying participations. The taxable dividend inclusion increased from 60 to 70 per cent at the federal level and to at least 50 per cent at the cantonal level. In the area of international taxation, TRAF entitles Swiss permanent establishments of foreign companies to receive foreign tax credits under certain conditions.

As an important change, TRAF introduced a restriction on the capital contribution principle (see 'Withholding tax'), namely a 50:50 rule stating that distributions out of capital contribution reserves of companies listed in Switzerland will only benefit from the tax-free regime (ie, no withholding or income tax for Swiss-resident individuals on capital contribution reserves paid out) if the company makes a distribution out of taxable reserves of at least the same amount. A comparable rule applies in case of a share buy-back on the second trading line, where at minimum the same amount of capital contribution reserves and other reserves must be used.

Contemplated Swiss withholding tax and securities transfer tax reform

On 14 April 2021, the Swiss Federal Council submitted the Dispatch concerning a reform of the Swiss Withholding Tax Act. The proposed reform foresees the abolishment of Swiss withholding tax on interest payments (with the exemption of interest on current accounts of Swiss resident individuals with Swiss banks).

The contemplated Swiss withholding tax reform is a welcomed step to strengthen the Swiss capital market, as Swiss legal entities as well as non-Swiss investors would not suffer potential Swiss withholding tax on interest payments from Swiss debtors (eg, a Swiss bond). It is accommodated by the abolishment of Swiss securities transfer tax on Swiss bonds, which makes it more attractive to purchase Swiss bonds over a Swiss securities' dealer. The reform will, however, likely not be resolved by the parliament before the end of 2021 and will likely not enter into force before 2023.

In addition, the Swiss Federal Council submitted a reform proposal for the withholding tax ordinance to the consultation procedure, which concerns the domestic notification procedure (instead of the withholding and reclaim and refund procedure) on dividend distributions by a Swiss company to its Swiss parent company. The relevant participation quota will be reduced from 20 per cent to 10 per cent.

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Recent changes relevant for financial institutions

The prolongation of the withholding exemption on interest paid on 'coco-bonds' or write-off bonds, respectively, until 31 December 2021 (it is currently envisaged to be prolonged until 31 December 2026) keeps these instruments attractive to foreign investors. The planned withholding tax reform (mentioned above) will further contribute to the attractiveness of the Swiss capital market and also make other Swiss bonds attractive to corporate investors and will lead to attractive new business opportunities for Swiss financial institutions.

From an international perspective, Swiss financial institutions – but also other Swiss-resident corporates – are increasingly affected by international transparency initiatives, such as the automatic exchange of information (first exchange of collected information by Switzerland in September 2018), the US Foreign Account Tax Compliance Act or the spontaneous exchange of tax rulings (first rulings exchanged by Switzerland in May 2018). Also, certain types of structured products (eg, securities lending) are under increased scrutiny by the Swiss Federal Tax Authority with regard to the refund of Swiss withholding tax, as the beneficial ownership is often challenged. A number of court cases are currently pending in Switzerland in this regard.

General tax considerations for Swiss M&A transactions

Taxable acquisitions and dispositions: asset deal versus share deal

In the case of taxable acquisitions or dispositions, Swiss-resident buyers and sellers often have contrary interests. A (Swiss) buyer often prefers an asset deal, whereas a (Swiss) seller typically prefers a share deal, owing to the facts outlined below:

Asset deal

Buyers generally prefer an asset deal to limit their risks from the acquired business, to achieve a step-up in tax basis and to have the possibility to offset financing expenses with operating income. Compared to a sale of shares, capital gains resulting from sales of assets are generally subject to full corporate income taxes (no participation relief applicable) at the level of the selling company. The subsequent distribution of such proceeds to the shareholders constitutes a generally taxable dividend (with privileged taxation of qualifying dividends for Swiss individuals and participation relief for Swiss corporate shareholders). Against this background, sellers generally prefer a share deal, where the capital gains are either generally tax-exempt for Swiss individuals or can benefit from participation relief (see below).

An asset deal is often considered when only part of an entity (eg, one business division) is to be sold. The asset deal gives the buyer the possibility to acquire only the required assets and to acquire them with the right acquiring entity (eg, to centralise IP directly in one entity). Also in such cases, it may be possible for the seller to realise a share deal by way of a tax-neutral demerger (see comments below) of the business (or part of it) to be sold to a new Swiss company and subsequent sale of the shares in this Swiss company.

If single assets are acquired, the purchase price needs to be allocated to the different assets. Based on accounting provisions, the acquired assets will be stepped up to their fair market value, which is relevant for capital gains tax purposes for the buyer in the case of a future sale. This also allows the buyer to depreciate or amortise such assets from their new basis for accounting and tax purposes. Any tax-loss carry-forwards of the selling entity are not transferred to the buyer, but remain with the selling entity (and may be set off against the capital gains realised upon the asset deal).

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Should the purchase price exceed the fair market value of the assets acquired in the purchase of a business, the exceeding part of the purchase price may be allocated to goodwill. Goodwill generally is to be depreciated in the Swiss financial accounts of a Swiss-resident buyer, with tax regulations allowing either a 40 per cent annual depreciation on a declining balance basis over five years or 20 per cent annual on a straight-line basis (general depreciation options for intangibles). The amortisation period may also be shorter or longer, depending on the expected lifetime of the respective intangible.

Generally, no historic tax liabilities are assumed by a buyer (with certain exceptions of a joint and several liability with the seller or tax succession, respectively, eg, for VAT (if seller does not carry on a business and deregisters for VAT purposes or a (part of) a business unit is transferred to a related party) or social security contributions.

Among the downsides of asset deals is the transfer of contracts with suppliers, service providers, etc with the consent of the counterparty who may use this to renegotiate existing agreements Furthermore, an asset-by-asset deal may require more (legal) work and set-up of individual acquisition entities in the case of cross-border transactions. Last, the risk of a fully taxable capital gain for the seller tends to increase the purchase price for the buyer. The tax benefit for the buyer arising from the higher amortisation and set-off of financing costs in the acquisition entity with income from the acquired business may outweigh this. If real estate is sold, Swiss real estate gains tax respectively property transfer tax may be applicable. These taxes vary from canton to canton and, in cantons applying the monistic system, real estate capital gains tax instead of corporate income tax applies, which may be significantly higher. Should taxable securities be sold as part of the assets, securities transfer tax needs to be considered as well, if a Swiss securities dealer is involved.

From a VAT perspective, the transfer of assets generally is subject to 7.7 or 2.5 per cent VAT, but often the mandatory or voluntary notification procedure applies when a business unit is transferred between Swiss VAT registered persons.

Share deal

In practice, sellers generally prefer a share deal owing to the applicability of the participation relief (federal and cantonal or communal level). Corporate sellers may benefit from participation relief on the capital gain, provided that shares of at least 10 per cent in another corporation, which have been held by the seller for at least one year, are sold. Swiss-resident individuals selling shares as private assets generally benefit from a tax-free capital gain on the sale of shares (with different limitations).

At the buyer level, the purchase price is fully attributable to the acquired shares, which cannot be depreciated in a Swiss acquisition company unless their fair market value declines. Goodwill cannot be separately capitalised in the balance sheet.

A reduction in value (impairment) is tax-deductible (eg, reduces net profit) for the Swiss corporate buyer. Consequently, a subsequent increase in value is subject to corporate income taxation. A revaluation of a qualifying participation that has been depreciated (ie, a participation of at least 10 per cent), has to be made if the impairment is no longer justified (claw-back provision).

Historic tax risks remain with the Swiss target entity and will crystallise at this company's level. Likewise, any deferred tax liability on the difference between market and tax book values of assets remains with the acquired Swiss target and is usually reflected in the purchase price. Tax

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loss carry-forwards of the acquired company generally remain available for future use (subject to certain limitations due to deemed tax abuse, eg, the sale of a factually liquidated company). However, the tax-loss carry-forward is generally not confirmed in the context of tax assessments by the tax authorities, which may make a respective valuation difficult.

Real estate gains tax (generally to be paid by the seller) or property transfer tax, respectively, may be triggered if a (majority) shareholding in a real estate company is sold, as this qualifies in most cantons or communities as economic change of ownership of the underlying Swiss real estate.

If a Swiss securities dealer is involved in a share deal (as a party or intermediary), securities transfer tax may be triggered.

In the case of a share deal, no VAT applies, since the transfer of shares is exempt from VAT. An often-incurred withholding tax issue a buyer should consider is the 'old reserves theory' as established by the Swiss Federal Tax Authority. It applies to retained earnings subject to a potential non-refundable withholding tax on dividends, for example, owing to a non-Swiss seller or selling entity that does not benefit from a full withholding tax refund under an applicable double tax treaty. If due to a change of ownership the non-refundable withholding tax would be reduced to a lower rate than pre-deal, Swiss tax authorities may qualify the distributable reserves as earmarked at the higher (pre-deal) withholding tax rate with the consequence that future dividend distributions of the 'tainted' reserves are subject to non-refundable withholding tax up to this higher rate. The amount subject to the higher withholding tax rate is usually the lower of retained earnings of the Swiss target company (distributable reserves for corporate law purposes, subject to withholding tax) and non-operating assets (not needed for the conduct of the business, at group level) at the time of change of ownership. There are also further anti-abuse theories with respect to past non-refundable withholding tax in the case, for example, of a partial or full liquidation of the Swiss target after an acquisition, which should be considered by a buyer.

Swiss-resident individual sellers that benefit from a tax-free capital gain on the sale of privately held shares in a Swiss or foreign entity may face retroactive taxation in the case of an indirect partial liquidation. If the target has distributable reserves (for corporate law purposes, subject to withholding tax) and non-business-related assets in the group that are distributed by the buyer within five years after the sale, this amount is taxable as dividend for the seller. Thus, the seller generally includes a share purchase agreement (SPA) indemnity clause, under which the buyer needs to indemnify against a potential indirect partial liquidation triggered (see comments below) during a five-year blocking period.

The downsides of a share purchase generally are the lack of a tax-efficient amortisation of the purchase price as well as the reduced availability of debt pushdown options on the level of the Swiss operating company (see 'Acquisition financing').

Tax-free acquisitions and dispositions

In contrast to taxable acquisitions and dispositions, there are various types of tax-free acquisitions and dispositions of domestic entities, which are tax-neutral on the basis that the relevant conditions are fulfilled, for instance:

- merger;
- demerger;
- conversion; and
- transfer of assets within a group.

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Swiss tax treatment of such reorganisations follows a 'substance over form' approach, that is, generally considers the end result (independent of how it was structured from a legal perspective).

As a general condition for income tax neutrality, a continued tax liability in Switzerland and a transfer at the (tax) book values is required. Apart from this, Swiss tax legislation and the applicable circular published by the Swiss Federal Tax Authority state the specific conditions to be fulfilled for each type of reorganisation.

Tax-neutral reorganisation as pre-transaction step

As mentioned, sellers typically prefer a share deal. In order to shape the target to its ideal form, pre-deal carve-in or carve-out transactions are quite common. Similarly, conversions of partnerships or sole proprietorships into corporations before a sale are often seen, but need to comply with a five year holding period before a sale of the shares in order to qualify as tax-neutral.

Pre-deal carve-outs are usually structured as a tax-neutral demerger, for example, with a spin-off of the business unit to be sold or to be kept to a new Swiss company. Such demerger mainly requires that a business unit (or part of it) remains with the transferring company and a business unit (or part of it) is transferred to the new Swiss company and continued. However, there is no holding period (ie, shares in the entity with the spun-off business can be sold immediately after the demerger). The requirements to qualify for a business unit or partial business unit are as follows – it is required that:

- the company performs services in the market or towards affiliated entities;
- the company has its own personnel; and
- the personnel expenses are appropriate, that is, in proportion to the revenues.

In the case of a demerger of a holding company or a mixed holding company, the Swiss Federal Tax Authority's practice requires for the qualification of a (partial) business unit that:

- the investments in subsidiaries concern predominantly active companies; and
- include at least two qualifying participations (of at least 20 per cent or warranting the exercise of a controlling influence by other means) in such companies.

With the Federal Court Decision of 11 March 2019 (2C_34/2018), the court deviated from this practice and considered it sufficient for a split-up of a holding company if the remaining and the transferred part consist of only one operationally active subsidiary, each, as this was – based on the transparency theory applied – equal to the spin-off of the underlying operational business itself. This court decision brings new possibilities for pre-deal structuring for mixed holding companies, that is, it should be sufficient for tax neutrality if one participation of over 50 per cent in an operationally active Swiss company is transferred, constituting a business unit.

Attention should be paid to the fact that tax-neutral intragroup transfers of (partial) business units or operating assets at (tax) book value lead to a five-year blocking period over the asset transferred and the shares in the transferring and receiving entities. If breached, the transferred hidden reserves are retroactively taxed. In the case of a contemplated asset or share deal, this is an important aspect that should be reviewed prior to the transaction by the seller or might also be something that should be reviewed by an interested buyer as it may restrict possibilities for post-transaction integration.

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More restrictive withholding tax practice of the Swiss Federal Tax Authority

The Swiss Federal Tax Authority's interpretation of anti-abuse limitations has become more restrictive in recent years; this can inter alia be noticed in Swiss M&A transactions in the following areas.

In the context of a tax-neutral quasi-merger (ie, share-for-share transfer with the contribution of a participation that is controlled by the transferor after the contribution against the issuance of new shares), new qualifying capital contribution reserves may be created (which are not subject to withholding tax upon distribution and not subject to income tax at the level of Swiss resident individuals holding the shares as private assets; certain limitations now apply for listed companies – see above in relation to TRAF). The Swiss Federal Tax Authority has, against this background, established a practice (based on an old court case) where such capital contribution reserves created will retroactively be denied if the contributed participation is absorbed or liquidated within a five-year period upon its contribution (ie, treatment like a direct side-stream merger). To the extent that such capital contribution reserves have been distributed in the past, this could lead to income and adverse withholding tax consequences. The practice also applies in case of contributions of shares of minimum 10 per cent (with or without capital increase) between corporate entities.

The second area is the above-mentioned old reserves cases where a latent non-refundable withholding tax burden is acquired. Cases of (partial) liquidation on behalf of the seller, where the acquired Swiss target is either merged or assets or participations are transferred out by the Swiss target, are subject to more scrutiny, when the Swiss target was held, for example, by foreign shareholders or private equity funds directly. This practice is relevant for the integration plans of a buyer since the withholding tax basis is much higher than under the old reserves practice: the hidden reserves of the Swiss target in the partial liquidation are also subject to the previous non-refundable withholding tax rate in this case.

The Swiss Federal Tax Authority's interpretation of anti-abuse limitations has also become more restrictive in cross-border constellations in recent years. Owing to an 'international transposition', the refund of Swiss withholding tax will be denied based on the practice of the Swiss Federal Tax Authority if a person not entitled to a full refund transfers the shares in a Swiss company to a Swiss company controlled by the same person by way of sale against a loan or against share capital increase of the receiving entity respectively a contribution into the capital contribution reserves of the receiving entity. This practice has recently been extended and is also applied to certain acquisitions by Swiss acquisition companies, which are financed via shareholder loans or capital contribution reserves (an extended international transposition). The tightened-up practice is especially relevant for investments by private equity funds.

Acquisition financing

Swiss acquisitions are often structured with a non-Swiss acquisition or financing company. Often, a Luxembourg-resident company is used, which is leveraged with required bank financing for the acquisition (often guaranteed by a subsidiary with upstream guarantees or collateral; a Swiss subsidiary can provide such securities or guarantees up to the amount of its distributable equity).

One reason for this are mainly better conditions for acquisition financing: Switzerland still levies a 1 per cent issuance stamp duty on equity contributions by direct shareholders (abolition of this tax has been discussed, but plans are on hold) and lending to a Swiss company needs to comply with the Swiss 10/20 Non-Bank-Rules, in order to avoid adverse withholding tax

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consequences on the interest paid. Also, there is no tax consolidation in Switzerland, and possibilities for a debt push-down in case of a share deal are generally limited. With the planned withholding tax reform mentioned above, we expect that acquisition financing to a Swiss company will become more attractive. A set-off of interest expenses on the acquisition financing may be possible if the deal can be structured with a purchase by a Swiss-resident operational company, which may use the expenses to be set off against its operational, taxable income.

Should this not be possible, there may still be structuring options to achieve a debt push-down, for example, the distribution of debt-financed dividends (leveraged dividends), whereby the target company resolves a dividend that is not directly settled in cash, but left outstanding as an interest-bearing downstream loan by the shareholder or settled by the assumption of external acquisition debt and the allocation of interest expenses to the target company. In addition, debt financed intergroup acquisitions, such as the acquisition of shares or assets from group companies by the Swiss target against an interest-bearing loan, may be possible.

For intragroup loans, the Swiss thin capitalisation rules must be considered, since related-party debt exceeding the maximum permitted debt for tax purposes is qualified as hidden equity, and interest on such hidden equity is not tax-deductible but considered as deemed dividend subject to withholding tax. The Federal Tax Authority annually publishes safe haven maximum and minimum interest rates for intercompany loans. The safe haven rates are quite low, but in each case, the possibility of using a higher or lower interest rate remains open, if the respective arm's-length character can be evidenced.

Landmark transactions

Public tender offer and squeeze-out merger over Alpiq Holding shares

Schweizer Kraftwerksbeteiligungs-AG, a subsidiary of CSA Energy-Infrastructure Switzerland, acting in concert with Primeo Energy/KSM and EOS Holding, launched a public tender offer on all publicly held shares in Alpiq Holding, which was completed in October 2019. Subsequently, a squeeze-out merger was resolved, which was completed on 29 June 2020. As a result of these transactions, Alpiq Holding now has a Swiss shareholder structure.

Sale of Specialty Ingredients business by Lonza

On 8 February 2021, Lonza entered into a definitive agreement with Bain Capital and Cinven to sell Lonza's Specialty Ingredients business and operations for an enterprise value of 4.2 billion Swiss francs. The divestment will allow Lonza to refocus its business as a pure-play partner to the healthcare industry.

Lonza's Specialty Ingredients business operates across 17 manufacturing sites globally and has approximately 2,800 permanent employees. The business is a leading provider of microbial control solutions for professional hygiene and personal care products. It also offers the custom development and manufacturing of speciality chemicals and composites to support the electronics, aerospace, food and agrochemical industries. The transaction is anticipated to close in second half of 2021, subject to customary closing conditions.

The transaction included some pre-deal restructuring in the form of a spin-off of the US business and a subsequent share-for-share exchange.

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Acquisition of Sunrise Communications by Liberty Global

After its pre-announcement for its public tender offer to acquire all publicly held shares of Sunrise Communications Group AG and following receipt of the regulatory approvals, Liberty Global successfully completed the acquisition of Sunrise Communications in November 2020. Total transaction value amounted to approximately US$7.15 billion and was the largest transaction in Switzerland in 2020.

Far Point Acquisition Corporation merges with Global Blue

In January 2020, Far Point Acquisition Corporation, a special purpose acquisition company co-sponsored by the institutional asset manager Third Point LLC, and Swiss-based Global Blue, a strategic technology and payments partner empowering global merchants to capture the growth of international shoppers, announced that they would merge. As a result, Global Blue will become a publicly traded company on the New York Stock Exchange. The deal is structured as a triangular reverse merger. Far Point and new investors, including Ant Financial Services Group, the operator of Alipay, will invest a total of approximately US$ 1 billion, reflecting a total enterprise value of Global Blue of €2.3 billion.

General tax considerations for cross-border M&A transactions

An inbound, immigration transaction can be structured in different ways, as follows.

Immigration merger

An immigration merger (inbound) basically has to respect the domestic merger law provisions; thus, for an inbound merger, the same provisions apply as for a Swiss domestic merger. Consequently, an inbound merger can be carried out tax-free, if the conditions for a Swiss domestic merger are met. The main question is, whether the foreign legislation permits an immigration merger and under which conditions. If the foreign company to be merged with a Swiss company has hidden reserves, generally no step-up of the income tax values for Swiss tax purposes was available since tax followed the accounting treatment. However, as from 1 January 2020, there is a legal basis for hidden reserves (including goodwill) of a foreign company merged into a Swiss company (excluding any hidden reserves on qualifying participations) to be stepped up on a tax-neutral basis to market values for Swiss corporate income and capital tax purposes, irrespective of the book values for accounting purposes. The transferred goodwill can be depreciated for tax purposes within 10 years. Thus, we expect this option to become more popular. The same rules apply in the case of a change of domicile or shift of the place of effective management or the transfer of relevant asset functions to Switzerland.

Quasi-merger

A very popular alternative to an immigration merger or a transfer of seat of a foreign company to Switzerland is a cross-border quasi-merger. A quasi-merger is a share-forshare exchange between an acquiring and a target company, whereby the shareholders of the target company receive at least 50 per cent of the value of their compensation in the form of new shares of the acquiring company, and the target company legally survives as a subsidiary of the acquiring company, whereby the acquiring company must control at least 50 per cent of the voting rights in the target company after the transaction.

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Such qualifying quasi-mergers with Swiss and foreign target companies are principally tax-neutral for the companies involved. Foreign-resident shareholders of the foreign target company are not taxed in Switzerland. Swiss-resident private individual shareholders of the foreign target company generally realise a tax-neutral capital gain (or loss) on the entire quasi-merger consideration. The immigration quasi-merger can typically be done tax-neutrally at fair market value and the share premium at the level of the Swiss acquiring company generally qualifies as capital contribution reserves, which can be distributed without withholding tax. The limitations introduced for Swiss-listed entities (see TRAF) do not apply for distributions out of foreign capital contribution reserves that are or were created, for instance, by quasi-mergers with contributions of non-Swiss participations. Certain limitations may need to be considered (see 'More restrictive withholding tax practice'), in the case of mergers or liquidations within five years of a quasi-merger.

Landmark transactions

Most cross-border transactions (into Switzerland) have happened over the past 10 years and were structured as quasi-mergers. From a tax perspective, such quasi-mergers resulted in significant capital contribution reserves, for example, in the case of the combination of LafargeHolcim under a common Swiss holding company. In the past five years or so, many relocations or inbound transfers have covered offshore entities. A recent and public case was the relocation of CEVA Group from the Marshall Islands to Switzerland. This was structured as a tax-neutral downstream merger into a Swiss subsidiary. Another transaction (not implemented) was the intended combination of Huntsman and Clariant, with a tax-neutral share-for-share transfer of Huntsman into Clariant; these plans were aborted at the end of 2017.

Key tax issues in M&A transactions – tax practice points for M&A dealmakers

In the case of an asset or share deal, the Swiss tax-related objectives of a Swiss seller and buyer are often, as outlined above, diametrically different. To find the most tax-efficient deal structure is often subject to longer negotiations. However, Swiss individuals as sellers will usually insist on share deals and it is market practice that a buyer has to accept an indirect partial liquidation indemnity obligation under the SPA.

Depending on the structure of the deal, the focus of the tax due diligence will be different: in the case of a share deal, a buyer generally inherits all historic tax risks of the target, but in the case of an asset deal, certain taxes foresee joint and several liability of the buyer with the seller, and acquired real estate can be encumbered with a pledge for past real estate taxes (without the necessity of registering such pledge in the real estate register).

From a buyer's perspective, there are certain potential pitfalls that should be considered with regard to acquisition financing; for example:

- the issuance stamp duty on direct equity financing into a Swiss company, which can be mitigated in the case of grandparent contributions or by making use of exemptions for reorganisations (eg, certain share contributions);
- limited interest deductibility for intragroup financing owing to thin capitalisation limitations and low safe-haven interest rates;
- Swiss 10/20 Non-Bank-Rules to avoid Swiss interest withholding tax of a Swiss borrower, which means that the Swiss borrower may not have more than 10 non-banks as lenders under one facility with the same terms; Swiss interest withholding tax can also be triggered

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in the case of a foreign borrower with downstream guarantees by a Swiss parent entity and a detrimental use of the funds in Switzerland or, in certain cases, also upstream or cross-stream guarantees or securities by Swiss entities. The practice with respect to detrimental downstream guarantees by Swiss parents has been relaxed by the Swiss Federal Tax Authority in spring 2019. Thus, the acquisition financing agreements require specific language to cover this topic and are often subject to Swiss tax ruling confirmations;
- no tax consolidation for income tax purposes and thus limited options for a debt push-down; this should be reflected when modelling the purchase price or tax benefits of the financing; and
- repatriation of funds from the Swiss target to serve the external debt without triggering indirect partial liquidation limitations (in the case of Swiss individual sellers, eg, by arm's-length upstream loans) or dividend withholding tax leakage; non-refundable withholding tax on dividends may apply either due to the situation of the seller (eg, old reserves practice or the extended international transposition) or if the acquisition company is not entitled to a full withholding tax refund under an applicable double-tax treaty. The withholding tax reduction under a double tax treaty especially requires, apart from beneficial ownership and fulfilment of the general conditions (shareholding quota, minimum holding period), that the acquisition company has sufficient substance from the perspective of the Swiss Federal Tax Authority. The withholding tax exemption under a double tax treaty has to be applied for in order to benefit from a reduction at source and the Swiss Federal Tax Authority usually requests detailed information about the rationale and set-up of the acquisition company.

With a share deal, Swiss withholding tax aspects in general should not be neglected. The Swiss concepts of 'old reserves', respectively '(partial) liquidation by proxy', are a speciality of Swiss tax practice of which a buyer is often unaware. In order to assess potential exposure in this regard, which may give the possibility to negotiate a lower purchase price, a buyer also needs to look at the past shareholder history (ie, not only the situation as per signing of the transaction).

Other relevant aspects for a buyer in tax due diligence are in particular:
- existing blocking periods, for instance, from past reorganisations that need to be considered in the context of potential post-closing integration work;
- deferred tax liabilities on hidden reserves that are permitted from a Swiss tax perspective, for example, inventory allowance, lump-sum allowance for bad debt; and
- deferred tax liabilities arising from past depreciation of shares in subsidiaries. Such depreciation may need to be reversed after the transaction in case higher values can be justified (eg, based on the purchase price).

A very positive aspect of Switzerland as a tax jurisdiction is the easy access to tax authorities and the broad possibilities to obtain advance tax ruling confirmations within a reasonable time frame. This is particularly important in transactions to obtain certainty, for example, whether the requirements of a tax-neutral reorganisation are met, whether certain upstream loans or distributions do not trigger the indirect partial liquidation taxation or whether certain upstream guarantees by Swiss entities do not trigger interest withholding tax for loans to foreign borrowers. Transactional tax rulings with a unilateral context are generally not subject to the international ruling exchange. Tax rulings that were obtained by the Swiss target may also reduce tax risks for the buyer. For

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any tax rulings, it is important to note that they are only binding to the extent the relevant facts are fully disclosed and the described transaction is actually implemented as described.

Swiss securities transfer tax aspects in share deals should not be forgotten. Financial institutions in Switzerland are used to this tax, but it should be noted that each corporation in Switzerland may qualify as a Swiss securities dealer and as such become subject to securities transfer tax, if it acts as a party to a deal or is involved as an intermediary. The tax applies both to the transfer of Swiss or foreign shares (or other securities and bonds). The Swiss Federal Court recently tightened the requirements that a securities dealer can rely on the fact that the other party also qualifies as securities dealer – if the evidence is not provided within a short time frame, the securities dealer has to pay both parts of the securities transfer tax.

The latest tax reform (TRAF), as described above, and the reduction of income and capital tax rates by cantons, further increased the attractiveness of Switzerland as a tax jurisdiction. The lower tax rates have an impact on valuation models in M&A transactions, for instance, for post-tax cashflow, but also the value of tax losses and the valuation of transitional measures (eg, separate cantonal tax rate until 2024 for certain income). The impact of potential future developments at the international level (eg, the OECD approach on challenges arising from the digitalisation of the economy, which will have an impact on the global tax framework) also needs to be monitored in the context of M&A transactions, since assumptions for the valuation of the estimated tax burden may be affected.

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Appendix 1

About the Authors

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Susanne Schreiber is a partner at Bär & Karrer AG and co-heads the tax department.

Susanne Schreiber has extensive experience in international corporate tax matters, in particular in domestic and cross-border M&A transactions and reorganisations. She advises on the tax aspects of financing and acquisition structuring, as well as capital market transactions and management incentive schemes.

She frequently works on vendor or buy-side transactions for private equity clients, multinationals or individuals, covering due diligence and pre-deal structuring, as well as carve-outs and post-merger integration from a tax perspective.

Furthermore, Susanne Schreiber regularly supports Swiss multinationals in their tax planning work, including tax advice on restructurings, financing and tax litigation work.

Susanne Schreiber is a German tax adviser as well as a Swiss-certified tax expert and attorney-at-law. Before joining Bär & Karrer she worked for an international law firm in Germany and for one of the big four companies in Zurich, where she last headed the Swiss M&A tax department.

Cyrill Diefenbacher
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Cyrill Diefenbacher is a senior associate at Bär & Karrer AG. He has broad experience in national and international corporate tax matters.

He advises clients on tax-related questions in the area of M&A transactions, restructurings and financing, and also has broad experience in advising clients in the area of tax compliance. He frequently works on M&A transactions (buy-side or sell-side advice over all stages of the transaction, advice on management incentive schemes), restructurings and reorganisations and provides advice on various national or international corporate tax matters. His area of expertise includes Swiss VAT.

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Cyrill Diefenbacher regularly speaks in the area of M&A tax or corporate tax law and publishes specialist articles in the field of taxes. He is a lecturer at the EXPERTsuisse Swiss Certified Tax Expert education programme.

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