BÄR & KARRER

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SWISS 10/20/100 NON-BANK RULE

LEGAL BASIS

Unlike many countries, Switzerland does not levy an interest withholding tax on interest paid on private and commercial loans (including on arm's length inter-company loans). However, a 35% federal withholding tax is levied on interest paid to Swiss or foreign lenders on bonds and similar collective debt instruments issued by or on behalf of Swiss resident issuers, as well as on interest paid by Swiss banks.

NOTIONS OF BOND, DEBENTURE AND BANK FOR FEDERAL WITHHOLDING TAX PURPOSES

The federal withholding tax definition of the notions of „bond" and „debenture" is broader than the notions used by civil law or in the financial markets. Swiss withholding tax practice defines bonds or debentures as written debt acknowledgments for fixed amounts which are issued in multiple tranches at comparable conditions for the purpose of collective financing, and which allow the investor to evidence, reclaim or transfer its receivable claim.

Loans qualify as **bonds** for federal withholding tax purposes where the following conditions are met:

- A borrower issues written debt acknowledgments over fixed amounts;
- these written debt acknowledgments are based on a single credit agreement and have identical conditions;
- the lenders include more than 10 non-banks (including certain types of sub-participants), i.e. not including Swiss or foreign banks as defined by the Swiss Federal Banking Act or comparable foreign banking legislation at the place of establishment of the lender; and
- the aggregate amount of issued debt amounts to at least CHF 500'000.

Loans qualify as **debentures** similar to bonds for federal withholding tax purposes under the following conditions:

- A borrower issues written debt acknowledgments over fixed amounts;
- the debt acknowledgments may have variable conditions;
- the lenders include more than 20 non-banks (as described above); and
- he total borrowed amount corresponds to at least CHF 500'000.

Taxable bank interest includes interest paid by Swiss banks or Swiss branches of foreign banks acting under a banking license. In addition, it includes interest paid by any Swiss resident entity that publicly solicits interest-bearing deposits, or continuously accepts interest-bearing deposits from more than 100 depositors (not counting Swiss or foreign banks as defined by the applicable banking legislation), whereby the aggregate amount of deposits amounts to at least CHF 5'000'000.

Banks (as described above), as well as any corporate entities under the control or covered by accounting consolidation of the Swiss borrower are not counted as lenders/depositors for purposes of these „10/20/100 non-bank rules" („intercompany exemption"). However, where the 10/20/100 non-bank rules (taking account of the intercompany exemption) are breached and a taxable bond or debenture results, federal withholding tax of 35% of the gross interest becomes applicable to the interest due by the Swiss borrower to any of its lenders within the debt category for which the „nonbank rules" have been breached (i.e. including bank and intercompany lenders that would not be counted as „harmful" lenders). A refund of such withholding tax may be obtained on the basis of an applicable double tax treaty (foreign lender) or Swiss domestic law (Swiss lender).

NON-SWISS BORROWERS/ISSUERS

Interest paid or accrued on bonds/debentures issued by non-Swiss borrowers is generally not subject to Swiss federal withholding tax, regardless of whether the 10/20/100 non-bank rules are complied with or not. However, such actual or deemed bonds/debentures issued outside of Switzerland may be likened to Swiss bonds/debentures for federal withholding tax purposes where the following conditions are cumulatively met:

> The foreign issued bond/debenture is guaranteed by a direct or indirect Swiss parent company of the issuer by way of a down-stream guarantee (according to long-standing administrative practice, guarantees provided by other Swiss affiliates of the foreign issuer – so called up- and cross-stream guarantees – are generally not considered harmful as Swiss corporate law limits the validity of such guarantees to the guarantor's freely distributable reserves);
> the proceeds from the issuance of the bond/ debenture are directly or indirectly on-lent to one or more Swiss affiliates of the foreign issuer; and
> such on-lending to Swiss affiliates exceeds the sum of (i) the combined accounting equity of all non-Swiss subsidiaries directly or indirectly controlled by the Swiss parent company, plus (ii) the aggregate amount of loans granted by the Swiss parent and its Swiss subsidiaries to its non-Swiss affiliates (the modalities for calculating these thresholds having to be agreed in an advance tax ruling with the Swiss Federal Tax Administration).

As under the above conditions the bond/debenture issued by a non-Swiss borrower is deemed to be a Swiss bond/ debenture, the 10/20/100 non-bank rule has to be complied with, otherwise a 35% Swiss interest withholding tax becomes applicable to the interest payments or accruals on such foreign issued bond/debenture.

CONTRACTUAL SAFEGUARDS

In order to prevent Swiss interest withholding tax from becoming applicable, credit facility agreements entered into by a Swiss borrower, or by a non-Swiss borrower under a guarantee with a Swiss parent company, should state that:

> the lenders must ensure that whilst the credit in question is outstanding, no assignments, transfers or relevant sub-participations of loan tranches shall be made, as a result of which the number of 10 non-bank lenders would be exceeded; and
> the borrower must ensure that it will at no time have more than 20 non-bank lenders under any of its borrowings (in both cases generally not counting any affiliated lenders).

In the situation of non-Swiss borrowers issuing „bonds/ debentures" with a guarantee of the Swiss parent company (assuming that the above-mentioned transfer restrictions designed to ensure compliance with the non-bank lender rules are disregarded), the borrower must undertake that:

> any flow-back of proceeds from the bond/debenture issue to Swiss affiliates is excluded; or at least
> flow-backs of proceeds from the bond/debenture issue will not exceed the sum of (i) the combined accounting equity of all non-Swiss subsidiaries of the Swiss parent

company, and (ii) the aggregate amount of loans granted by the Swiss parent and its Swiss subsidiaries to non-Swiss affiliates.

CONCLUSIONS

External debt financing transactions involving either a Swiss resident borrower, or a Swiss resident parent company guarantor for a foreign debt issue (provided some of the debt proceeds are planned to flow back to Switzerland), compliance with the 10/20/100 non-bank rules through implementation of appropriate contractual safeguards is indispensable in order to keep the financing outside the scope of Swiss federal withholding tax on interest.

To obtain certainty on the Swiss withholding tax implications, it is recommendable to apply to the Swiss Federal Tax Administration for an advance tax ruling.

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