Uncertain futures

Philippe Weber, Manuel Werder, Daniel Eisele and **Elga Reana Tozzi** of **Niederer Kraft Frey** review the Swiss investment framework and the foreign investment control law that Covid-19 has put on ice

Switzerland implemented a broad range of measures for businesses in response to Covid-19, including restrictions on certain commercial, border crossings and gatherings exceeding a certain number of people. However, as the situation has stabilised, the Swiss government has adopted a step-by-step plan to lift many of these restrictions. Importantly, the Swiss government was quick to decide on a robust package of government aid (including government-backed credit, short-time work allowances, etc.) which thanks to characteristic Swiss efficiency reached businesses without delay and bureaucratic hurdles.

Swiss and foreign-owned Swiss domiciled companies with a turnover in 2019 of less than CHF500 million ($515 million) that have been significantly adversely affected by Covid-19 can obtain loans of up to a maximum of 10% of their revenue or a maximum of CHF20 million. Swiss commercial banks are required to pay out up to CHF500,000 per company upon request without any further requirements and the federal government will act as a guarantor for the full amount. Interest on these loans is 0.0% per annum. For loan amounts exceeding CHF500,000, the federal government will act as a guarantor for 85% of the principal amount of the loan. Interest on the 85% of the principal amount of these loans is 0.5% per annum. Interest on the remaining 15% is subject to negotiation with the bank. Further support packages involve financial support to start-ups and extended support to businesses in form of short-term work (i.e. part-time unemployment) compensation.

Regardless of this support, the environment makes any predictions about Chinese inbound investment into Switzerland very difficult to make. The increasingly uncertain business outlook in general may result in decreasing prices for targets. However, a less attractive seller market may also result in fewer targets being available.

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Ease of investing

Switzerland's attitude to foreign investors, including Chinese investors, is generally open and favourable. Unlike in the EU, no investment control measures have yet been introduced. However, in March 2020 the Swiss parliament asked the government to draft a law on foreign investment controls. The content of the proposal is not yet known and given the current environment it is uncertain whether parliament will introduce a foreign investment controls act at all. In any event, the entry into force of such an act within the next 12 months is highly unlikely.

The following factors motivate Chinese companies to undertake M&A transactions with Swiss companies:

- Switzerland offers economic, legal and political stability and security and benefits from an efficient and reliable administration, which has been in evidence during the Covid-19 crisis where the Swiss government reacted quickly, efficiently and in a measured manner; Switzerland was among the first countries to approve and effectively roll-out state aid;
- the Swiss legal and regulatory framework is favourable for M&A transactions with Chinese buyers (as further described below, there is a double taxation agreement between China and Switzerland and, so far, the free trade agreement between China and Switzerland is one of only few such agreements that China has concluded with a continental European country);
- Switzerland is rich in human capital and offers reliable and well-educated employees;
- M&A transactions with Swiss companies allow for an efficient inroad to advanced technical know-how;
- the acquisition of companies in Switzerland offers Chinese groups relatively quick and easy access to the Swiss market;
- it is a good way to acquire recognised brands (for example in technology or luxury goods), which may provide legitimacy in the Swiss, European and even global markets;
- Chinese buyers have the potential to increase the value of acquired Swiss companies (for instance by using valuable access to the Chinese and other markets).

In transactions involving Swiss companies that are listed on a stock exchange or are regulated (for instance financial institutions), proper disclosure of the Chinese buyer's ownership structure and regulatory status is becoming increasingly important, as evidenced by recent public cases, including that of HNA.

Overall, however, there are no Swiss laws of general application prohibiting foreign investments in Switzerland or subjecting them to prior approval. Therefore, foreign investors generally do not need formal approval for their investments in Switzerland and no special governmental authority monitors foreign investments. Foreign investments in certain regulated industries might require governmental permission. The competent authority and the approval process and timings depend on the specific industry.

Regulatory considerations

Investment restrictions do exist in certain sectors, and while as a rule the government is not entitled to golden shares, it may make approvals or licensing subject to certain conditions.

Financial market laws mean that if foreign nationals have a controlling influence over a bank, a securities trader or certain other prudentially supervised entities active in the financial sector (finance companies), the granting of a licence by the Swiss Financial Market Supervisory Authority (Finma) is subject to additional requirements. Among other things, the corporate name of the legal entity must not suggest that the entity is controlled by Swiss persons. Further, the country – or countries – where the ultimate owner of the controlling interest is domiciled must grant reciprocity (which is the case if the relevant state is a member of the World Trade Organisation). Finma may impose additional conditions to the licence.

Acquisitions of residential, but not commercial, real estate in Switzerland by foreign or foreign-controlled persons is

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subject to strict limitations under the Lex Koller. Such properties can only be acquired if authorisation is granted by the competent cantonal and federal authority(ies). Authorisation is not easily obtained and may take several weeks, if not months, to obtain.

The relevant licensing authorities can also refuse to grant a licence to companies incorporated under foreign laws under the telecommunications act for radio communication licences, the nuclear act for nuclear power plants, the radio/TV act for broadcasting licences and the aviation act for the professional transport of passengers or goods, unless reciprocal rights are granted to Swiss persons by the respective foreign states. In the aviation sector, an aviation company headquartered in Switzerland must be under the actual control of Swiss citizens.

Further investment restrictions apply in the following fields: air transportation; public transport (railway, cable cars, shipping); TV and radio; post and telecommunications; energy (especially nuclear energy); specific professions such as university medical profession, lawyers etc.; minerals, raw materials and mining; health services and products; casinos and gaming; private security services; and weapons and war material (including dual-use goods).

Competition clearance is another key regulatory consideration. The authority is the Swiss Federal Competition Commission (Comco). In the event of a merger or takeover of a Swiss bank which is considered necessary for reasons of creditor protection, Finma will replace Comco as the competent authority.

In the merger or acquisition of a controlling stake, Comco needs to be notified prior to deal closing if, in the last accounting period before the transaction the enterprises concerned reported a joint turnover of at least CHF2 billion or a turnover in Switzerland of at least CHF500 million; and if at least two of the enterprises concerned reported an individual turnover in Switzerland of at least CHF100 million. Special thresholds apply for banks and insurance companies. Filing needs to be done after the signing of the relevant agreement but prior to closing. On receiving notice of a transaction, Comco must inform the parties within one month whether it will open a formal investigation. If Comco does not inform the parties within that period, the transaction can proceed without reservation. If an investigation is opened, the parties cannot close the transaction. Comco must then complete the investigation in four months.

As a rule, and unless a licence stipulates otherwise in its terms, an increase in an investment will not trigger additional approval requirements unless the foreign investor newly acquires a controlling interest through the increase. For banks, securities traders and certain other prudentially supervised financial institutions, any increase of a participation exceeding a threshold of 10%, 20%, 33% or 50% of the capital or voting rights must be notified to Finma. The same applies if a foreign investor decreases / exits its investments in such a company. As a rule, there are no exit obstacles and the repatriation of profits and capital is possible.

As for currency regulations, as a principle unrestricted amounts of liquid funds, for instance cash, foreign currency and securities (bonds and cheques etc.), can be imported into Switzerland, brought through Switzerland in transit or exported from Switzerland. In the context of combating money laundering, certain declaration obligations (purpose, beneficial owner etc.) may arise, for example when transferring higher sums of money in foreign currencies or in the case of cross-border cash movement exceeding CHF10,000. To date, Switzerland has taken a very liberal approach to cryptocurrencies. For example, stock companies have been incorporated using cryptocurrencies to pay the company's capital.

Investment structures

The most common legal entities for inbound investments are stock companies (AG) and limited liability companies (GmbH). Both have capital divided into shares and limited liability. They are both suitable for operational and holding purposes. Listed companies are usually constituted as AGs. In addition, certain special forms of investment company (the Sicaf and the Sicav) are subject to the Collective Investment Schemes Act (Cisa). Sicaf is an investment company with fixed capital (close-ended) with the sole purpose of collective investment. Sicav is an investment company with variable capital (open-ended) whose capital is divided into entrepreneurial and investor shares. Sicafs and Sicavs are regulated by Cisa and supervised by Finma. As a non-corporate vehicle under the scope of Cisa, limited partnerships (LPs) are often used for collective investment.

These entities must be domiciled in Switzerland, must have the required minimum capital (CHF100,000 for an AG, CHF20,000 for a GmbH) and must be represented by at least one individual domiciled in Switzerland. Additionally, publicly traded companies and companies that exceed certain thresholds with respect to total assets, turnover or number of employees must have an auditor. If changes occur – such as amendments to the articles of association, changes in the company's capital structure or changes in the authorised representative – the competent commercial registry must be kept up to date. For Cisa-governed entities, various financial market regulations must be observed.

Dispute resolution

Parties often include an arbitration provision in their contractual documents for international commercial agreements governed by Swiss law. Arbitration is generally seen as the most efficient dispute mechanism for large, cross-border disputes. Whereas the parties to commercial agreements may sometimes also agree on an arbitration clause of the International Chamber of Commerce (ICC) or another arbitration institution, the most commonly used arbitration rules are the Swiss International Arbitration Rules of the Swiss Chambers' Arbitration Institution.

Switzerland has also signed over 120 bilateral investment protection treaties (BITs). According to the United Nations Conference on Trade and Development (UNCTAD), Switzerland has the third largest network of these treaties after Germany and China. The current BIT between Switzerland and China was signed in 2009 and has been in force since April 13 2010.

Where parties wish to agree on state courts, it is important that the jurisdiction clause refers to the competent courts of a certain city or canton, and not simply to the "ordinary courts in Switzerland", which would not be considered a valid choice of jurisdiction.

The Swiss court system is relatively efficient and the quality of the state courts is normally high. Depending on whether a court case involves an evidence proceeding and/or is of a cross-border nature (and may even involve judicial assistance proceedings), the duration of a proceeding varies substantially. Normal first instance proceedings may take one to three years. There is then an appeal proceeding before the highest cantonal court which usually takes one to two years. A decision by the highest cantonal court is generally subject to appeal to the Swiss Federal Supreme Court. Such appeal to the Swiss Federal Supreme Court has only suspensive effect in exceptional cases.

Foreign claimants should note that they may be required to provide security for costs upon request of the counterparty in state court proceedings.

Apart from having an efficient court system, Switzerland also remains, as indicated above, one of the foremost jurisdictions for arbitration. This position is the result of its liberal legal framework as well as its extensive and arbitration-benevolent case law and doctrine. In this regard, foreign investors should be aware that Swiss BITs systematically contain diagonal arbitration clauses, allowing investors to initiate arbitration directly against Switzerland. Most of these clauses provide for ad-hoc or International Centre for Settlement of Investment (ICSID) arbitration, while many others provide for ICC arbitration.

Sports related arbitration is also very important, as over half of all international sports federations have their seat in Switzerland. The Court of Arbitration for Sports domiciled in Switzerland regularly deals with international sports cases, such as the recent case between the Chinese swimmer Sun Yang and the International Swimming Federation.

Swiss courts will generally respect foreign judgments by a competent court, including by a Chinese court, unless the foreign court violated due process requirements or rendered a decision that is contrary to Swiss public policy. One of the key objections that a defendant can make in such an enforcement proceeding is that the foreign court was not competent to decide the matter. The enforcement of judgments rendered in countries of the EU, Norway and Iceland is governed by the Lugano Convention, which harmonises the conditions for enforcement and applicable procedures.

Foreign international arbitral awards are recognised and enforced in Switzerland on the basis of the New York Convention, regardless of reciprocity. Foreign ICSID investment arbitration awards will be recognised and enforced pursuant to Article 54 (1) of the ICSID Convention, which stipulates that ICSID awards will be enforced as though they were the final judgments of a domestic court.

Enforcement of Swiss court judgments abroad can generally be expected in those jurisdictions with which Switzerland has an agreement for the reciprocal enforcement of judgments. Since Switzerland is a signatory state of the Lugano Convention, Swiss court judgments are generally enforceable in all EU countries, as well as in Norway and Iceland. Whether a Swiss judgment is also enforceable in a particular foreign jurisdiction in the absence of a bilateral or multilateral agreement will depend on the local laws of that jurisdiction.

Arbitral awards rendered in Switzerland can generally be expected to be enforced in those jurisdictions that are signatories to the New York Convention. ICSID investment arbitration awards rendered in Switzerland will generally also be enforceable in all states that are signatories to the ICSID Convention.

The tax factor

A withholding tax (WHT) of 35% is levied on dividend payments. The WHT is paid by the distributing company. The repayment of share capital and capital contribution reserves is exempt from dividend WHT (special repayment rules will apply for Swiss listed companies as of 1st January 2020).

There is a double taxation agreement in place between Switzerland and China (DTA-PRC) which follows the OECD Model Tax Convention. Based on the DTA-PRC, the residual WHT rate on dividends amounts to 10%, meaning that 25% could be refunded. Under the net remittance procedure, dividends distributed to a Chinese holding company on a substantial participation of 25% in the capital of the distributing Swiss company could be reduced to a residual treaty rate of 5% based on the DTA-PRC.

No WHT is levied on interest payments on intra-group and shareholder loans. A

WHT of 35% is levied on bank and bond interest. Based on the DTA-PRC, the residual WHT rate amounts to 10% on such interest. Due to the beneficial DTA-PRC, there is no benefit in using intermediary tax jurisdictions.

Corporate income taxes have three levels: federal, cantonal and municipal/communal. The federal corporate effective tax rate equates to 7.83%. The applicable cantonal/communal tax rate depends on where the company is tax resident. Switzerland, as a confederation comprising 26 cantons, has no standard tax rate.

Following a substantial corporate tax reform that became effective on January 1 2020, the cantons have reduced or will reduce their corporate tax rates substantially. For the 2020 tax year, the Canton of Bern has the highest effective tax rate of about 21.61% (given the tax reform is not yet in place). On the other hand, the Canton of Geneva only has a tax rate of about 14.0%, when pre-tax reform it was about 24.16%. The most attractive cantons are the Canton of Zug, with an effective tax rate of 11.91% (especially if you take into account that the travel time between Zug and Zürich is only about 20 minutes) or the canton of Lucerne with an effective tax rate of approx. 12.32%. The Canton of Zürich has an effective tax rate of 21.15%, which will be reduced in the 2021 tax year to 19.71%. There is also an annual capital tax at a cantonal level due on the net equity of between 0.0717% and 0.4008% on net equity.

Since July 2016, Switzerland has applied revised regulations regarding the Swiss federal tax holiday scheme. The revised legislation provides for relief from federal corporate income tax for a maximum period of 10 years for industrial enterprises and production-related service providers. The federal tax incentives are linked to the number of newly created or maintained jobs by an enterprise domiciled in selected regional areas in Switzerland. It can lead to an annual tax credit of up to CHF95,000 for each newly created job and CHF47,500 for each maintained job. Depending on the number of newly created or maintained jobs, the effective tax rate may be substantially decreased to a low single-digit tax rate. There are also tax holiday schemes available at the cantonal level.