Daily Tax Report: International

INSIGHT: Swiss Withholding Tax Reform—Considerations for Multinationals with Swiss Operations

By Elga Reana Tozzi

July 27, 2020, 9:01 AM

Elga Reana Tozzi of Niederer Kraft Frey Ltd looks at the consultation draft recently published on the Swiss withholding tax reform and considers the implications for companies and non-Swiss investors.

The Swiss Federal Council published the consultation draft regarding the Swiss withholding tax reform and the abolishment of the Swiss securities transfer tax on Swiss debt instruments on April 3, 2020. The main objective of the proposed amendments to the Withholding Tax Act and Stamp Duty Act is to strengthen the Swiss capital market and to facilitate multinational enterprises (MNEs) to issue bonds in Switzerland. The aim is also that group financing functions are moved to Switzerland.

The consultation ran until July 8, 2020. However, the withholding tax reform cannot be discussed in the parliament earlier than 2021, which would mean that the amendments could no longer enter into force as of January 1, 2022.

Under the current withholding tax law and practice, interest paid on a bond issued by a Swiss tax resident issuer is subject to withholding of 35%. Non-Swiss tax resident investors are entitled to a full or partial refund of the withholding tax depending on the applicable double tax treaty in place between Switzerland and the jurisdiction of the bond holder's tax residency.

However, even if the full withholding tax were to be refunded, the administrative burden of the filing is considerable, and considering the cash shortage until the refund is remitted, in practice this is not attractive for foreign investors. Therefore, in the last few years, Swiss-based MNEs have issued bonds through non-Swiss subsidiaries based in a jurisdiction which does not levy withholding tax on bond interest.

Current Withholding Tax Law and Practice for Funds Flow Back to Switzerland

Based on a well-known tax practice, if a bond issued by a non-Swiss subsidiary is guaranteed by a direct or indirect Swiss parent company (down-stream guarantees) and the proceeds are lent to a Swiss tax resident company of the group, the withholding tax would be due on interest payments. In this case, it is deemed, for withholding tax purposes, that the Swiss parent company would have issued the bond directly.

At the beginning of 2019, the Federal Tax Administration issued a new practice to facilitate the issue of bonds by Swiss-based MNEs so that funds raised could flow to Switzerland without re-qualifying the non-Swiss bond as a Swiss bond, in which case the interest would be subject to withholding tax. The new practice allows that the funds could be on-lend to Swiss group companies, provided the amount does not exceed the combined accounting equity of all non-Swiss subsidiaries directly or indirectly controlled by the Swiss parent company plus the aggregate amount of loans granted by the Swiss parent company and its Swiss subsidiaries to its non-Swiss group companies.

Main Elements of Withholding Tax Reform

The main elements of the withholding tax reform are:

- partial introduction of paying agent principle for interest income;
- Swiss tax resident companies and non-Swiss investors should be exempt from Swiss withholding tax on interest payments;
- equal treatment of direct and indirect investments in interest paper of a fund or structured product;
- abolishment of Swiss securities transfer tax on Swiss bonds.

Introduction of Paying Agent Principle for Interest Income

The introduction of the paying agent principle for interest income would be a fundamental change of the withholding tax system in Switzerland. Under the paying agent principle, withholding tax would no longer be deducted and remitted by the debtor (e.g. the Swiss issuer of the bond based on the debtor paying system), but by the investor’s paying agent (e.g. the bank where the investor holds the bond in a custody account). The withholding tax would only be due if the paying agent were domiciled in Switzerland. In other words, if the paying agent is a non-Swiss bank, no withholding tax would be due on the interest paid on a bond issued by a Swiss tax resident company.

Exemption for Swiss Companies and Non-Swiss Investors

Swiss tax resident companies and non-Swiss tax resident investors would be exempt from Swiss withholding on interest payments, provided that they are paid by a paying agent. This would mean a Swiss branch of a foreign company would also benefit from the exemption, as well as Swiss-based funds. It should be noted that if the paying agent does not elect for the paying agent system, the debtor system would be applicable by default. In such a case, the non-Swiss investor may still benefit from the double tax treaty relief.

Withholding Tax on Interest Payments only to Swiss Tax Resident Individuals

The fundamental change to the paying agent system on interest payments would mean that for Swiss tax resident individuals, the Swiss withholding tax would be levied on all kind of interest payments, e.g. also on non-Swiss bonds, collective investment schemes or structured products if paid by a Swiss domiciled paying agent. Under current law, only interest paid by Swiss collective schemes based on the Swiss Collective Scheme Act is subject to withholding tax.

Abolishment of Swiss Securities Transfer Tax on Swiss Bonds

Swiss securities transfer tax is due on the sale and purchase of certain securities, including bonds, provided that a Swiss securities dealer is one of the parties (e.g. a Swiss bank, but also a Swiss company could qualify if there are more than 10 million Swiss francs ($10.6 million) securities on the balance sheet). The Swiss securities transfer tax amounts to 0.15% on bonds issued by a Swiss company or 0.3% on bonds issued by a foreign company.

To make it more attractive to invest in Swiss bonds, the Swiss securities transfer tax would be abolished on the sale and purchase of Swiss bonds if a Swiss securities dealer is be party to the transaction.

Key Takeaways

- It is anticipated that the consultation draft may be revisited and amended by the parliament; in particular, the concept that any interest payments remitted by a Swiss paying agent to a Swiss tax resident individual would be subject to withholding tax. This would have the result that on interest payments not only the foreign withholding tax would be deducted, but also the Swiss withholding tax.
- For MNEs it might be of interest to explore the possibility to have their group financing functions in Switzerland, given no withholding tax is due on interest payments on intra group loans.
- For MNEs there might be the possibility to issue a bond through a Swiss tax resident company without having the risk that interest payments would be subject to Swiss withholding tax.
- In any case, it is clear that the withholding tax system would change fundamentally through the introduction of an agent paying system.
- To strengthen the Swiss finance market further, the abolishment of the one-time capital duty on the issue of shares/equity will be discussed again.
- The goal would also be to abolish the securities transfer tax on all kinds of financial transactions.
- Realistically the new withholding tax rules may enter into force not before January 1, 2023.

Elga Reana Tozzi is Counsel with Niederer Kraft Frey Ltd, Zurich, Switzerland.

The author may be contacted at: elga.tozzi@nkf.ch

This column does not necessarily reflect the opinion of The Bureau of National Affairs, Inc. or its owners.