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Swiss withholding tax reform moves forward

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Further to the success of the popular vote on the Corporate tax reform on 19 May 2019, the Swiss Federal Council has reopened the discussion of a project to modify the withholding tax on interest that could significantly improve the access of Swiss-based companies to local and international financial markets.

Swiss withholding tax on interest is one of the main factors contributing to the general reluctance of international groups to rely on their Swiss entities for financing purposes. While a tax of 35% is levied on Swiss bonds, bank deposits and other comparable instruments in accordance with the practice of the Federal tax administration, foreign investors tend to acquire financial instruments with low or no withholding tax. Depending on the case, the reimbursement of withholding tax can be a long and a complicated process, or even be impossible.

The project under development is expected to improve the position of Swiss companies by completely abolishing withholding tax on interest paid to foreign investors, Swiss corporations and collective investment schemes.

Current situation

In accordance with the Swiss tax laws, withholding tax of 35% is due on bonds, bank deposits and loans guaranteed by real estate located in Switzerland. As a general rule, withholding tax is not levied on individual loan arrangements.

This being said, the practice developed by the Federal tax authorities can result in the qualification of individual loan agreements as bond-like instruments or bank deposits that are subject to withholding tax.

More specifically, withholding tax may arise in the following cases:

- Issuance of bond-like instruments (such as promissory notes) to more than 10 non-bank lenders on similar conditions or more than 20 non-bank lenders on different conditions;

- In case the number of creditors exceeds 100 and the amount of the borrowed funds is of at least CHF 5M;
- In case of payment of interest on upstream loans received from foreign group affiliates, provided that their obligations to third parties are guaranteed by the Swiss company. This can be the case if a direct / indirect subsidiary of a Swiss company issues bonds guaranteed by the latter and lends the raised funds to the Swiss company.

Even though the Federal tax administration has recently levied most restrictions related to the intragroup financing and increased the authorized amount of "upstream" loans that can be granted by foreign affiliates, the access of Swiss companies to third-party financing remains limited and has to be revised.

Abolishment of withholding tax on interest

In order to improve the position of Switzerland in the financial sector, the Federal Council has just adopted the general guidelines related to a new project of law that is expected to be presented for the public consultation in autumn 2019.

More specifically, the Federal Council intends to completely abolish withholding tax on interest paid to foreign investors, to collective investments schemes and to swiss legal entities.

The payment of interest to individuals residing in Switzerland will be subject to Swiss withholding tax irrespective of place of residence of the debtor. In this respect, it is expected to introduce the principle of paying agent, a third-party (usually, a bank) that will be responsible for levying withholding tax on taxable payments. The purpose of this change would be to encourage the individuals to declare their worldwide income and thereby reduce the tax evasion.

New responsibilities of Swiss banks

Swiss banks are expected to become paying agents that will have to comply with the new regulations. In particular, the banks will have to identify the payee of interest and levy withholding tax, if necessary. The Federal Council is currently examining the possibility to temporarily compensate the costs of the banks related to the implementation of the new legislation.

It is expected that the banks will have the possibility to outsource the tasks related to their withholding tax obligations in order to reduce their administrative charge. This would not however result in the transfer of their responsibilities.

Particular cases

A transitional regime is expected to be introduced for certain financial instruments issued by systematically important banks ("Too big to fail") such as Coco bonds, bail-bonds and write-off bonds.

The withholding tax treatment of structured products and compensatory payments remains under discussion and is expected to be outlined in the project of law.

Other measures

Some other measures such as the cancellation of the Stamp duty tax on the transfer of Swiss bonds or modification of the mechanism of participation relief are currently being examined and may also be included into the project of the law.

The complete abolishment of the Transfer stamp duty tax and the decrease of the Withholding tax rate on dividend payments have been withdrawn from the current reform due to their significant cost for the Confederation. It is not excluded that these measures will be reintroduced in the following tax reforms.

Conclusion

The cancellation of withholding tax on interest payments to foreign investors, swiss corporate entities and collective investment schemes should reinforce the position of Switzerland on international level and improve the access of Swiss entities to the financial markets.

At the same time, Swiss banks should already start analyzing the practical aspects of the implementation of the reform as the upcoming changes are expected to create significant administrative burden.

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