Barbara Brauchli Rohrer*

Tax Considerations for M&A Transactions and Restructurings in Switzerland

This article details the principal tax considerations relevant for M&A transactions and restructurings in Switzerland. It explains the main reorganization schemes and their Swiss tax consequences, as well as the differences between asset deals and share deals from a Swiss tax point of view.

1. Main Reorganization Schemes

1.1. Introductory remarks

On 1 July 2004, the Federal Act on Mergers, Demergers, Transformations and Asset Transfers (Merger Act)[1] entered into force. On 1 June 2004, the Swiss Federal Tax Authorities (FTA) issued a circular letter that details how the rules of the Merger Act should be applied by the tax authorities in practice.

1.2. Statutory merger

1.2.1. Initial comments

A merger can take the form of either a statutory merger (merger by absorption or merger by combination) or a share-for-share transaction (quasi-merger, *see* section 1.3.). In a merger by absorption, all assets and liabilities are transferred to the absorbing company and the absorbed company is dissolved. In a merger by combination, a new company is formed and the existing companies transfer their assets and liabilities to the new company.

1.2.2. Merging companies

Mergers can be performed corporate income tax neutral, provided:
- the assets and liabilities are transferred at tax book values, i.e. no step-up in basis; and
- the tax liability remains in Switzerland.

The tax attributes of the merged company are generally taken over by the surviving company. This also holds true for any tax loss carry-forwards of the merged company, under the reservation of any tax avoidance schemes. In the case of a merger where the parent company is absorbing its subsidiary, any merger loss is generally not tax deductible. Only in cases where the merger loss is an economic loss (i.e. no hidden reserves) and the participation in the subsidiary should have been depreciated, such merger loss will be accepted and can be used for tax purposes. Any merger gain will be treated as dividend income and will be taxed accordingly, taking into consideration the participation relief, if applicable.

Usually, mergers do not trigger any issuance stamp duty or securities transfer tax consequences. Furthermore, a merger does not have any withholding tax consequences, provided the reserves and the retained earnings of the merged company are transferred to the surviving company. For VAT purposes, the notification procedure (i.e. a notification instead of paying VAT) should apply in cases where the involved parties qualify as VAT taxpayers.

1.2.3. Shareholders of merging companies

At shareholder level, if shares are held as private assets, a merger does not lead to any income tax consequences, provided the shareholders are not receiving any equalization payments or nominal value increases. At shareholder level, if shares are held as business assets, a merger does not lead to any income tax consequences, provided the book values of the shares remain unchanged. In cases where a merger involves an insolvent company, special rules apply and different tax consequences result.

1.3. Quasi-merger

In a quasi-merger, the shareholder contributes its participation into the acquiring company. A quasi-merger does not lead to the dissolution of the acquired company.

Quasi-mergers can be performed income tax neutral, provided:
- at least 50% of the voting rights of the acquired company are contributed; and
- the shareholder's remuneration does not consist of cash payments or loans exceeding 50% of the value of the acquired company.

A quasi-merger requires a capital increase in the acquiring company and is tax neutral for the acquiring company as well as for the contributed company.

At shareholder level, a quasi-merger does not lead to any income tax consequences for shareholders holding their shares as private assets. This also applies to shareholders who hold their shares as business assets, provided the book values of the shares of the acquired company correspond to the book values of the shares of the contributed company. It has to be noted that a statutory merger following a quasi-merger might lead to tax consequences at shareholder level because the tax authorities would qualify the whole transaction as a statutory merger – provided the

* **Partner, Wenger & Vieli AG. The author can be contacted at b.brauchli@wengervieli.ch.**

1. CH: Federal Act on Mergers, Demergers, Conversions and Asset Transfers (*Bundesgesetz über Fusion, Spaltung, Umwandlung und Vermögensübertragung/Loi fédérale sur la fusion, la scission, la transformation et le transfert de patrimoine*), 2003.

statutory merger is performed within five years after the quasi-merger – and therefore apply the tax considerations as explained in section 1.2.

1.4. Demerger

A demerger can be executed either as a split-up or as a split-off. In a split-up, all assets and liabilities are transferred by the transferring company to at least two existing or new companies and the transferring company is dissolved. In a split-off, certain assets and liabilities are transferred by the transferring company to one existing or new company. The transferring company continues to exist.

Demergers are income tax neutral, provided:
- the assets and liabilities are transferred at tax book values, i.e. no step-up in basis;
- the tax liability remains in Switzerland; and
- the assets and liabilities (both transferred and untransferred) represent a business or part of a business, and the transferring company as well as the receiving company continue to operate such business.

There is no blocking period on the shares in the transferring company or on the shares in the receiving company. As no blocking period exists, the tax authorities are carefully reviewing whether the requirements (i.e. businesses in both companies and continuation of such businesses) of the tax neutral demerger are fulfilled.

Demergers do not trigger any issuance stamp duty or securities transfer tax consequences if qualified as tax neutral for income tax purposes. Furthermore, a demerger does not have any withholding tax consequences, provided the reserves and retained earnings are transferred to the acquiring company. For VAT purposes, the notification procedure should apply.

1.5. Spin-off

A spin-off is a transfer of assets and liabilities from the transferring company to an existing or new subsidiary company.

A spin-off is income tax neutral, provided:
- the tax liability remains in Switzerland;
- the assets and liabilities are transferred at tax book values, i.e. no step-up in basis; and
- a five-year blocking period is observed. Such blocking period applies to the transferred business as well as to the shares in the subsidiary that received the business.

A spin-off does not trigger any issuance stamp duty or securities transfer tax consequences if qualified as tax neutral for income tax purposes. For VAT purposes, the notification procedure should apply.

2. Asset Deal versus Share Deal

2.1. Asset deal

An asset deal allows the purchaser to acquire a clearly defined part of the business. Because assets are acquired, a step-up in the basis and future depreciation of the assets is possible. The acquisition financing and, therefore, the acquisition costs are borne by the company that acquired the business, which allows a set-off of the interest expenses against the taxable operating income of the acquired business. Generally, the purchaser bears no, or only limited, historical tax liabilities.

Whereas the asset deal is usually the preferred scenario for a potential purchaser, a Swiss seller – especially a Swiss individual holding his shares as private assets – generally prefers a share deal. This is due to the fact that Swiss individuals are not taxed on capital gains realized by the disposal of movable assets (*see* section 2.3.).

2.2. Share deal

In a share deal, the purchaser acquires the target company with all tax attributes (e.g. tax loss carry-forwards, tax book values, historical tax risks). No step-up in basis is possible. The acquisition financing (and therefore the acquisition costs) are not incurred by the target company, so that a set-off of the interest expenses against the taxable operating income of the target company is not possible.

2.3. Indirect partial liquidation

Due to the possibility to realize capital gains tax free, privately held companies often had, and still have, substantial retained earnings. Such earnings are sold with the company and, shortly after the sale, are distributed to the new corporate owner of the company. As a result, the theory of indirect partial liquidation was developed. Under this theory, accumulated funds of the target company are taxed at the seller's level in cases where the target company has distributed such funds to the purchaser after the acquisition. After years of applying this theory, it has been formally adopted into tax law, and a respective circular has been published by the FTA.[2]

An indirect partial liquidation is assumed, provided:
- participation rights are sold by a Swiss resident individual holding the participation rights as private assets to a purchaser holding them as business assets;
- at least 20% of a company's participation rights are transferred by one or several shareholders;
- non-business-related and distributable (from a Swiss commercial law perspective) assets exist at the date of sale and are distributed within a five-year period; and
- seller and purchaser are cooperating (such cooperation is usually assumed).

If the above conditions are cumulatively met, the tax-free capital gain is (partly) requalified into a taxable dividend distribution.

The basis for the taxation corresponds to the smallest amount of the following elements:
- purchase price including amounts under conditions;

2. Art. 20a para. 1 lit. a Direct Federal Tax Law (*Bundesgesetz über die direkte Bundessteuer/Loi fédérale sur l'impôt fédéral direct*, DBG/LFIFD), Circular Letter of the FTA No 14 of 6 November 2007.

– amount of substance distribution (reorganizations, especially mergers between the acquisition company and the target company, may also qualify as harmful distribution) after the acquisition;
– amount of distributable retained earnings as per the last balance sheet date before the sale; and
– amount of non-business-related assets.

In order to avoid the potential negative tax impact resulting from post-deal actions of a purchaser, sellers usually insist on a respective tax clause in the share purchase agreement to ensure that the purchaser is liable for any tax consequences the seller bears resulting from an indirect partial liquidation.

3. Conclusions

Switzerland has a friendly environment when it comes to corporate reorganizations. If carefully planned and executed, such reorganizations are generally tax neutral. Care needs to be taken when blocking periods apply and also in the case of conditions that need to be fulfilled to ensure the tax neutrality of such reorganizations. Concerning acquisitions of Swiss companies, Swiss individual sellers often opt for a share deal in order to ensure their tax-free capital gain.