4. Swiss Tax Reform Aimed at Strengthening the Swiss Capital Market

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I. Introduction

The Swiss Federal Council has launched a tax reform package to strengthen the Swiss capital market by facilitating the raising of capital.

The federal withholding tax and the federal transfer tax negatively impact the attractiveness of the Swiss capital market. At the same time, certain shortfalls of the Swiss withholding tax system have become evident in today's environment. The tax reform proposed by the Federal Council intends to address both issues.

As part of a tax reform package, the Federal Council suggests a departure from the debtor principle - inherent in Swiss withholding tax law – towards the paying agent principle. The tax reform will thereby enable the Swiss withholding tax to better serve its principal purpose of being a security tax raised at source in order to ensure compliance for income tax purposes.

The consultation procedure on the tax reform bill was initiated by the Federal Council on April 3, 2020 and will last until July 8, 2020[1)].

II. Key Elements of the Tax Reform

The tax reform bill provides for the following key elements:

- Exemption of domestic legal entities and foreign investors from the federal withholding tax on Swiss source interest income.
- Implementation of the withholding tax's principal purpose of being a security tax raised at source for the income tax by subjecting foreign source interest income of Swiss resident individuals to the federal withholding tax. Swiss resident paying agents, typically the banks, will thus levy the federal withholding tax. This will allow to eliminate a material shortfall in Swiss withholding tax law whilst at the same time to effectively combat domestic tax evasion.
- Equal treatment of direct and indirect investments, thereby strengthening the Swiss capital market.
- Exemption of Swiss bonds from the federal transfer stamp tax.

III. Current Legal Framework

Swiss Capital Market

The federal withholding tax and the federal transfer tax on Swiss bonds are widely considered a major drawback of the Swiss capital market.

Under current Swiss withholding tax law, the statutory rate of withholding tax on interest-bearing investments (bonds) is 35%. The federal withholding tax is levied irrespective of whether the investor is a private or an institutional investor, a Swiss or a foreign resident investor. Foreign resident investors may fully or partially claim a withholding tax refund, depending on the applicable double taxation treaty concluded between their country of residence and Switzerland, if any. The claim for a full or partial withholding tax refund, as the case may be, by foreign resident investors vis-à-vis the Swiss Federal Tax Administration involves an administrative effort and a temporary liquidity shortage.

In order to avoid the federal withholding tax on interest, Swiss groups of companies usually issue their bonds abroad, preferably in jurisdictions with no tax at source. Thereby, the Swiss groups ensure maximum attractiveness of their bonds for the investors, but, at the same time, they create added value and the jobs associated with it abroad.

The federal transfer stamp tax is levied on the sale of certain securities, including bonds. The tax is triggered if at least one of the parties involved in the sales transaction is a Swiss securities dealer. Each securities dealer involved in the transaction is subject to half the tax. In the case of Swiss securities, the total tax amounts to 0.15% of the sales proceeds. In the case of foreign securities, the tax levied amounts to 0.3% of the sales proceeds.

Security Tax Raised at Source

Swiss resident investors are entitled to claim a full refund of the federal withholding tax, provided they have properly reported the interest income in their tax return. Domestically, the federal withholding tax serves as a security tax at source. The withholding tax thus guarantees the levy of the income tax on Swiss source dividend and interest income.

The Swiss withholding tax law, however, falls short with respect to foreign source dividend and interest income. In the case of foreign securities – including bonds issued abroad by Swiss groups - no Swiss federal withholding tax is levied, despite the fact that dividend and interest income from foreign securities is also included in the tax base for the purpose of income tax.

IV. Brief Review

The present bill on the tax reform is not the first proposal by the Federal Council. The last attempt to introduce tax measures aiming at increasing the attractiveness of the Swiss capital market was made in 2014. Due to the controversial reactions to the then proposed tax reform during the consultation procedure, the Federal Council decided to postpone the planned tax reform.

In 2019, the Federal Council addressed the tax reform to strengthen the Swiss capital market twice and adopted the key elements set forth in Section II above. Thereafter, the Federal Council instructed the Federal Department of Finance to prepare the consultation draft.

The consultation procedure on the withholding tax reform bill started on April 3, 2020 and will last until July 8, 2020.

In comparison with previous tax reform proposals, the Federal Council suggests certain measures which aim at reducing the complexity of the tax reform and minimizing the settlement and liability risks, namely:

- limitation of the tax reform to interest-bearing investments;

- the federal withholding tax on interest income will be payable only by Swiss resident individuals;
- the Swiss resident paying agents will have to pay the federal withholding tax to the Federal Tax Administration on a quarterly basis only;
- interest accrued on bonds at the time of the sales transaction will not be subjected to withholding tax;
- Swiss resident paying agents will only be liable in the case of willful intent; and
- Swiss resident paying agents will be compensated for their implementation efforts.

V. Envisaged Tax Measures

The tax reform proposed by the Federal Council envisages the exemption of domestic legal entities and foreign investors from the federal withholding tax on interest-bearing investments.

Groups of companies, including Swiss groups, will have the opportunity to issue bonds in Switzerland without the federal withholding tax burden for their investors. It is expected that the envisaged tax reform will enhance intra-group financing activities in Switzerland and, thus, generate additional Swiss tax revenue.

As an additional measure to strengthen the Swiss capital market, the proposed tax reform intends to abolish the federal transfer stamp tax on Swiss bonds.

The implementation of the proposed tax reform requires the adoption of the paying agent principle and the abolition of the debtor principle. The withholding tax will no longer be levied by the debtor of the interest income (i.e. the bond issuer), but rather by the Swiss resident paying agent of the investor, who normally is the bank with whom the investor holds the securities deposit.

Furthermore, the Swiss resident paying agents will not only levy the withholding tax on Swiss source interest income, but also on interest income of foreign securities.

The change in federal withholding tax from the debtor principle to the paying agent principle is expected to enhance the primary purpose of withholding tax as a security tax raised at source for the income tax. Thus, the introduction of the paying agent principle is intended to be an effective measure against tax evasion domestically.

Due to the expected fiscal impact, the tax reform will take its time. The tax reform is expected to be brought before Swiss Parliament at the earliest in 2021 and to become effective at the earliest in 2022[2).]

1) https://www.estv.admin.ch/estv/de/home/verrechnungssteuer/verrechnungssteuer.html

2) https://dievolkswirtschaft.ch/de/2020/04/reform-der-verrechnungssteuer-bundesrat-staerkt-fremdkapitalmarkt-und-sicherungszweck/

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