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Can Swiss companies continue to pay tax-free dividends?

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On 1 January 2020, the rules around the taxing of dividend distributions of Swiss companies listed in Switzerland will be changing.

Key takeaways

- The new regulations taking effect on 1 January 2020 will apply to Swiss companies listed on a stock exchange in Switzerland.
- Under the current law, valid until 31 December 2019, dividends may be distributed up to 100% free of Swiss dividend withholding tax if the dividend comes from capital contribution reserves.
- According to the new regulations, tax-free repayments of capital contribution reserves will still be possible, provided that the company distributes taxable dividends to the same extent from other reserves (if any). If the restriction on repayments is not adhered to, taxation will occur in the extent of the breach.
- There will be exceptions for capital contribution reserves, those formed as part of cross-border reorganisations, as well as relocations of companies to Switzerland, or which will be paid back within the group.

What is a tax-free dividend?

If a Swiss company distributes a dividend, that dividend, generally speaking, is subject to dividend withholding tax of 35%. Shareholders residing outside of Switzerland can only receive relief from Swiss dividend withholding tax insofar as this is provided for in a double tax treaty. Depending on the specific double tax treaty applicable, the percentage holding in the Swiss company and the legal nature of the shareholder, there may possibly remain a residual Swiss dividend withholding tax burden of between 5% and 15%. Moreover, if, for example, Swiss shares are held by investment funds, practically speaking, it may be somewhat complicated to claim double tax treaty relief.

If, however, the Swiss company has capital contribution reserves and the dividend is distributed from these capital contribution reserves, then the dividend, under the current law, will be completely free of Swiss dividend withholding tax. These dividend distributions are also income tax free for individuals in Switzerland.

In recent years, on a number of occasions, Swiss companies have distributed such tax-free dividends. In addition, holding structures of shareholders residing outside of Switzerland sometimes rely exclusively on the chance that the Swiss company will distribute tax-free dividends from capital contribution reserves.

In addition to capital contribution reserves, registered share capital can also be repaid tax-free. Repayment of registered share capital, however, is conditional upon a formal capital reduction process and, as a result, is both more costly and complicated than a distribution of capital contribution reserves. Further, repayment of only the shares' face value is tax-free (as opposed to the shares' market value).

What are capital contribution reserves?

Capital contribution reserves are the company's shareholders' contributions that exceed the face value of the registered share capital. An example of this is capital surplus when shares are issued. Swiss company law also allows shareholders to contribute funds directly to the company's reserves without shares being issued in return. Capital contribution reserves can result not only from cash contributions but also from contributions in kind.

For example, in cross-border reorganizations, capital contribution reserves may be created by contributing shares in a foreign company to a Swiss subsidiary. In the past, such reorganizations were used specifically to create capital contribution reserves in Switzerland, which could then be distributed to shareholders free of Swiss dividend withholding tax.

Distributing capital contribution reserves to the current shareholder is tax-free, whether or not the capital contribution reserves were created through the current shareholder's contributions or through a previous shareholder's contributions.

What is changing as regards tax-free dividends?

For Swiss companies not listed on a stock exchange in Switzerland, nothing is changing. These companies can continue to distribute dividends from capital contribution reserves entirely tax-free.

For Swiss companies listed on a stock exchange in Switzerland, the rules around tax-free dividend distributions will be changing as of 1 January 2020. From that date, these companies can only distribute capital contribution reserves to their shareholders tax-free if a dividend, of at least 50% of the total distribution, is distributed from reserves (typically, from retained earnings) that are subject to Swiss dividend withholding tax. These minimum distribution rules, however, only apply if the company has reserves (typically, retained earnings) that are subject to dividend withholding tax.

Therefore, under the new tax regulations, the overall volume of capital contribution reserves that can be repaid tax-free will remain unchanged. However, unless an exception applies, one may no longer distribute an individual dividend 100% tax-free. Rather, a taxable portion must now be distributed along with the tax free portion.

If registered share capital is reduced, all Swiss companies will continue to benefit from a tax-free repayment of the share’s face value. The new rules, however, around the minimum usage of taxable reserves, shall also apply to the creation of new face value from capital contribution reserves that the company may already have , i.e., when issuing bonus shares.

Are there any exceptions?

There are also some exceptions to the new restriction on the repayment issue regarding tax-free capital contribution reserves. In the cases mentioned below, even Swiss companies listed on a stock exchange in Switzerland, can continue to distribute dividends from capital contribution reserves 100% tax-free:

- Capital contribution reserves created by contributing shares or other membership rights in a foreign stock corporation, or in a cooperative, or a cross-border transfer to a Swiss subsidiary after 24 February 2008 as part of merger-like amalgamations;
- Capital contribution reserves which, at the time of a cross-border reorganization, merger, or relocation of a company from overseas to Switzerland after 24 February 2008 were previously available to the overseas company;
- Capital contribution reserves that are distributed to a legal entity with at least a 10% holding in the distributing Swiss company; or
- If the Swiss company is liquidated or if the Swiss company undergoes a relocation overseas.

Need for action?

At least for those dividends that are still due for payment in the current calendar year 2019, the previous rules will hold, meaning that these dividends can be distributed 100% free of Swiss dividend withholding tax.

Shareholders residing outside Switzerland should review their holding structure. Where applicable, the holding structure should be modified so that double tax treaty relief can be claimed in the optimum manner. When making changes to the holding structure, thought should be given to the Swiss old reserves practice with regard to pre-existing reserves in the Swiss company that, when distributed, are subject to dividend withholding tax (in particular retained earnings).

Theoretically, a complete delisting of the Swiss company would be possible. Generally speaking, it would also be conceivable to replace the current Swiss listing of a Swiss company with a listing of another group company based overseas. Another possibility would be to replace the Swiss listing of the Swiss company with a listing on a stock exchange overseas only. If, however, a Swiss company has different share categories (e.g., ordinary and preferred shares) where one category is listed on a Swiss stock exchange and the other is not, then, according to the wording of the law, the new distribution restrictions also may possibly apply to dividend payments to the category not listed in Switzerland.

Regarding share capital increases, from a tax point of view, Swiss companies should consider whether it is preferable to create high face value and a low capital surplus.

Judging from the list of exceptions, it may remain attractive for foreign companies to bring capital contribution reserves into Switzerland, even after 1 January 2020. According to the wording of the law, even for capital contribution reserves that are only created after 1 January 2020, it should be possible for these to be used for 100% tax-free dividend payments, provided that the capital contribution reserves are created in Switzerland through either eligible cross-border reorganizations or the relocation of a company to Switzerland.

Furthermore, repayments to legal entities, holding at least 10% of the distributing Swiss company, can still be made 100% tax-free. This exception, however, should be exercised with caution. Swiss company law recognizes the principle of equal treatment of all shareholders. Therefore, if a company, in addition to shareholders with holdings of more than 10%, also has shareholders with holdings below that threshold (quite typical for listed companies), all company law restrictions should be checked beforehand.

Shareholders and Swiss companies should pay close attention to further developments. It is expected that the Swiss tax authorities will comment on currently outstanding issues of interpretation and application, including transitional law issues, in a circular letter.

Nils Harbeke

Partner
Swiss Certified Tax Expert, Attorney at law
Head of Tax Practice Group

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 92 24
nils.harbeke@pestalozzilaw.com

Jonas Sigrist

Partner
Attorney at law, Swiss Certified Tax Expert

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 93 26
jonas.sigrist@pestalozzilaw.com

Silvia Zimmermann

Senior Counsel
Attorney at law, Dr. iur., LL.M.

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 92 48
silvia.zimmermann@pestalozzilaw.com

Severin Roelli

Partner
Attorney at law, LL.M.

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 92 68
severin.roelli@pestalozzilaw.com

Franz Schubiger

Partner
Attorney at law, LL.M.
Co-Head Life Sciences

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 92 49
franz.schubiger@pestalozzilaw.com