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Switzerland: Investing in Switzerland - Some Avoidable Pitfalls
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Formation of Companies and other Corporate Entities

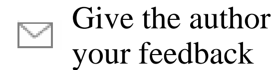
For commercial purposes, Swiss corporate laws offer to the foreign investor a variety of legal vehicles. The most popular form of corporate entity is the share corporation which can be established with a minimum share capital of CHF 100’000. The higher of CHF 50’000 or 20 percent of the nominal face value must be paid in at the time the entity is formed. Since May 1, 2001, the nominal face value can be as little as 1 cent per share (before, the minimal nominal face value was CHF 10 per share). A company name can be chosen more or less freely, with few to no restrictions.

A Swiss share corporation must have one or more board members, the majority of whom must be Swiss citizens residing in Switzerland. Board members have considerable responsibilities, among them the preparation of the annual financial statements and the corresponding business report, the establishment of adequate accounting practices, and the appointment and removal of management. The number of board meetings is left to the discretion of the board members and board meetings can be held abroad. The shareholders? meeting must be held once a year, usually within six months following the end of the fiscal year, in order to vote on the audited financial statements, to elect, reelect or remove board members and the auditors, as deemed necessary by the shareholders.

In the practitioner?s experience, Swiss share corporation law is relatively flexible and can accommodate sufficiently a foreign investor?s needs. Swiss share corporations are the most common legal form used by foreign investors who want to establish a company.

Other legal entities used for commercial purposes are the limited liability company and the general and limited partnership, but they are used less frequently than the share corporation. The limited liability company has reduced capital requirements, i.e., the minimum capital is CHF 20’000 and only half of the capital must be paid in at formation (note that this minimum is currently under legislative revision; the minimum capital is to be increased to CHF 40’000 with full payment). The maximum capital is CHF 2 mio. (to be lifted completely under current legislative action).

Further information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Limited liability companies and general and limited partnerships are most often used if the foreign investor has a need for a tax conduit. In particular, the limited liability company (LLC) can be structured in a hybrid way, i.e., the LLC is considered for Swiss tax purposes as a legal and taxable entity whereas foreign tax jurisdictions treat it as a flow through entity. This hybrid character may offer attractive tax planning opportunities.

One of the reasons to establish a share corporation is the relatively free transferablity of its shares whereas the equity interest in LLCs can be transferred only in connection with a notarial deed (a written contract will suffice under proposed legislation) and a corresponding entry in the local commercial register to which the public has access. Considering this, the share corporation provides increased or total anonymity either by registered or bearer shares. Another advantage of the share corporation is of course its limited liability, but this aspect also applies to LLCs and the limited partners of a limited partnership.

Finally, market perception is also an important factor when a foreign investor is deciding on the type of corporate vehicle to form or incorporate. One should note that the public considers a share corporation as a more serious business undertaking than an LLC, i.e., an LLC is still considered the preferred investment vehicle of small investors.

Establishment of a Branch

The establishment of a Swiss branch of a previously formed foreign company may offer interesting tax planning opportunities in comparison with the formation of a Swiss company. The use of a branch may be beneficial if the domestic tax law of the foreign enterprise or the applicable tax treaty provides for a tax exemption of the Swiss branch?s profits for taxes paid in Switzerland.

One should also consider that a profit repatriation from a Swiss branch to its foreign headquarters is not subject to the dividend withholding tax of 35 percent as is the case with a dividend distribution from a Swiss subsidiary to its foreign parent company. Though most Swiss tax treaties provide considerable reduction of the withholding tax, the zero withholding tax rate of a Swiss branch may provide for even greater tax advantages. In particular, if no tax treaty is available, or if the portion of the Swiss withholding tax that cannot be recovered from the Swiss federal tax authorities cannot be used as a deduction or credit on the foreign tax return, establishment of a Swiss branch may be the more prudent vehicle from a tax perspective.

The level of branch profit taxation in Switzerland is - generally speaking quite low since the same expense deductions that are available to Swiss subsidiaries of foreign parent companies are also granted to a Swiss branch. Also, the Swiss tax authorities usually accept that an arm?s length interest rate is presumed on that portion of funds received from the foreign headquarters, which is not treated as equity.

Another issue of branch taxation in Switzerland pertains to profit allocation. Though the various state tax authorities in Switzerland have different approaches, they tend to assume in international cases the "separate entity" approach, since the Swiss tax treaties usually provide for that method. In other words, the taxable income or the taxable loss of a Swiss branch is determined on its separate accounts and without taking into account the total group results. In other words, the set-off of an overall group loss in favor of the Swiss branch?s profit is not allowed.

Company Taxation

General Aspects

The federal corporate income tax in Switzerland is 8.5 percent which is quite low in comparison with other tax jurisdictions. However, unlike other countries, where federal taxation constitutes the main tax burden both for company and individual taxpayers, Switzerland?s state income taxes are usually more burdensome than the federal income tax. Accordingly, it makes sense for foreign investors to choose the right state (canton), and, within that state, the right community, to establish jurisdiction, since communities are also entitled to levy income and capital taxes based on a community multiplier applied to the state tax rate.

The more favorable corporate state tax regimes include the Cantons of Schwyz, Zug and Zürich, which have corporate state and local tax rates between 12 and 25 percent, depending on the community multiplier, which results in an overall federal and state tax rate of 20.5 percent to 33.5 percent.

Repatriation of Corporate Profits

There are no restrictions on the repatriation of profits and capital gains from Switzerland. From a tax perspective, one exception may exist. The taxing authorities, both on the federal and state levels, usually require the existence of a minimum debt-equity ratio of 70/30 which may result in reclassification of interest payments as dividend payments. In the case of reclassification, the subsidiary may be confronted with a 53 percent withholding tax (35 percent gross-up) on the reclassified interest payments.

Another exception is in the corporate law requirement for building up mandatory reserves (so-called "general reserves"). Five percent of annual net income must be allocated to the general reserves until such general reserve attains 20 percent of the paid-in share capital. After that, 10 percent of dividends which are paid in excess of a dividend of five percent and any proceeds received in excess of the par value in the case of further share issuance must also be allocated to general reserves. To the extent that general reserves do not exceed 50 percent of the share capital, general reserves can only be used to cover losses or to prevent or mitigate unemployment or other such measures. Special provisions on the establishment of general reserves apply to holding companies and licensed transportation and insurance businesses.

Dividends-Received Deduction

Corporate income tax laws in Switzerland provide for economic double taxation by levying income taxes both on corporate profits and on dividend income received by the shareholders. In situations where an additional company is interposed between the shareholder and the operating company, the result would be economic triple taxation.

In order to avoid such excessive taxation, Switzerland permits a company receiving dividends derived from qualifying holdings to reduce its federal and state corporate taxes by a formula on the ratio of net qualifying dividend over total net profits. To qualify for the tax relief described above, a Swiss company must own at least 20 percent of the registered capital of another company or a participation exceeding the fair market value of CHF 2 mio.

Holding Companies

First of all, one should note that the holding company concept in Switzerland is purely a state tax law concept, i.e., on the federal level, there is no general tax relief for holding companies. One exception is of course the above dividends-received deduction. As a result, a pure holding company is totally exempt from federal corporate income taxes earned through qualifying dividend

income.

Second, the federal tax reform act of 1997 introduced a favorable tax treatment for *capital gains* realized on company participations of more than 20 percent held for more than one year and acquired after January 1, 1997. As of January 1, 2001, the cantons are allowed but not required to introduce a similar tax relief on the state level. As an example, the canton of Zürich has enacted such a tax relief as of this date. Non-qualifying holdings acquired before January 1, 1997, can be sold in Zürich with a tax-free capital gain only after January, 1, 2007.

In addition, most of the cantons in Switzerland have adopted a holding company concept for tax purposes. Such holding companies are exempt from any state corporate tax income. This exemption includes income from dividends, interest, royalties and all capital gains.

Domiciliary companies

Domiciliary companies may not have any administrative activity in Switzerland and must be exclusively engaged in commercial activities abroad. They can range from small letterbox companies without any staff or other infrastructure to large operational headquarters of multinational companies. The activities of domiciliary companies typically include the management of investments such as real estate or securities, ancillary financing, brokerage accounts or commissions, exploitation of intellectual property, invoicing etc. However, acquisitions, market research and trading, agency and fiduciary activities are not allowed. The same is true for any sales activity in the territory of Switzerland whereas by contrast foreign-foreign sales are allowed.

The concept of a domiciliary company is a state tax concept, i.e., the tax reliefs provided to those companies are not available for federal tax purposes. Companies qualifying for the status of a domiciliary company are completely exempt from state income taxes on dividends and capital gains from financial participations.

Furthermore, foreign-foreign sales of domiciliary companies are only marginally taxed, which is the main reason for choosing this tax status, i.e., only a fraction of net income derived from foreign-foreign sales constitutes taxable income. By way of example, in the canton of Zürich, only five percent of such net income constitutes the tax basis which is then taxed at the ordinary tax rate of about 25 percent (depending on the community tax multiplier), which result in substance in tax rate of only 1.25 percent.

A further advantage of the domiciliary company is the so-called fifty-fifty practice, i.e., a domiciliary company may distribute 50 percent of its gross profits in the form of management or royalty fees without substantiation. Such tax relief can be requested under federal, state and community tax laws. The fifty-fifty rule is aimed at minimizing the number of tax litigation revolving around the evergreen issues of deductibility of expenses and constructive dividends. Any payment in excess of 50 percent must be justified. From the remaining income, only managerial expenses (to a limited extent) and taxes paid may be deducted.

Mixed Companies

Other than domiciliary companies, so-called mixed companies may have to some extent their own business activities. However, this business activity is predominantly foreign related. In the canton of Zürich for instance, a predominantly foreign related business activity is assumed if 80 percent of net income stems from foreign sources. In addition, the Zürich tax authorities require that 80

percent of the business expenses must be incurred in connection with foreign business activities.

Here again, only a fraction of net income derived from foreign-foreign sales constitutes taxable income. The canton of Zürich allows as a tax basis between 10 and 20 percent of the net income derived from the foreign-foreign sales which is again taxed at the ordinary tax rate. Mixed companies may also benefit from the above fifty-fifty rule.

Service Companies

If a Swiss group company provides services to other group companies of a multinational enterprise either in Switzerland or abroad, those service companies can apply for special tax relief whereby income taxation - both on the federal and the state levels - takes place on a cost plus basis. In the canton of Zürich, the cost plus method is (a) either 5 percent on all expenses including income taxes and other taxes or (b) 8.33 percent on the salary expenses. The cost plus taxation is very often subject to particular tax rulings in order to avoid unnecessary tax litigation. Service companies usually provide intragroup services such as technical, administrative or scientific assistance including research or promotion activities.

Newly Established Enterprises

For federal tax purposes, newly established enterprises are granted financial assistance on a case by case basis in the form of interest-free loans or bank guarantees.

On the state and community levels, there are tax privileges for newly established enterprises aimed at benefiting the state economy. Usually, those tax privileges include a complete tax exemption of up to ten years after the formation of the business. Enterprises not receiving the maximum tax relief can expect tax reductions of between 30 to 50 percent over varying periods of up to ten years.

All such tax relief depends on the type and amount of investment, the number of jobs created, and the regional development opportunities a particular enterprise may bring to the state. Not only have manufacturing enterprises been granted such tax relief, but also banks, insurance companies and accounting firms.

Venture Capital Firms

Effective since May 1, 2000, the Swiss Parliament has enacted a Federal Law Act on the Taxation of Venture Capital Firms. Qualifying venture capital firms are thereby freed from paying their stamp tax which is currently 1 percent for a share capital exceeding CHF 250’000. These venture firms may also qualify for the dividends-received deduction as explained above if they have holdings exceeding 5 percent (instead of 20 percent) or exceeding a fair market value of CHF 250’000 (instead of CHF 2 mio.). Furthermore, private investors granting subordinated loans to qualifying venture firms may be granted some tax relief on their federal tax return. Some states have also introduced similar legislation.

In order to qualify for such tax relief, the venture companies must invest at least 50 percent of their funds in so-called innovative and internationally focused projects. Also, they must be registered in Switzerland and they are required to conduct substantial operational activities in Switzerland. Furthermore, the shares of such a venture company must not be publicly traded and major companies having more than 100 employees cannot have shareholdings of more than 25 percent. Finally, the qualifying venture company is required to make its investments within the first five

years after the business begins its activity.

Taxation of Individuals

Taxation of Individuals in General

There is no room to address the income and wealth taxation of individuals residing in Switzerland or the taxation of their investments in Switzerland. Generally speaking, however, and depending on the state and the community in which the individual seeks has its tax residence, there are usually very interesting tax rates available, which makes it easier for businesses to attract qualified professionals. The following section addresses three tax planning tools where Switzerland can make a difference taxwise and compares Switzerland with other European and non-European countries.

Tax Freedom from Capital Gains

If an individual taxpayer in Switzerland sells privately-held assets, there is no tax on capital gains. Exceptions apply only to so-called professional investors who use, for instance, options or other derivative financial instruments as leverage. According to various Swiss Federal Supreme Court decisions, the following actions or characteristics may result in the qualification of an individual taxpayer as a professional investor: short holding periods between trades, particular professional knowledge, a certain level of trading frequency, or a strategic investment approach. If an individual taxpayer is deemed to be a professional investor, he or she will be subject to income tax on the capital gains from the transactions. There are no special capital gains tax rates in Switzerland, i.e., a capital gain is taxed at regular income tax rates.

Lump-Sum Taxation

A particularly attractive form of tax relief is available to persons who intend to reside in Switzerland for the first time or after an absence of more than 10 years if they do not engage in a professional activity, either self-employed or otherwise, in Switzerland. The individual may engage in a professional activity outside Switzerland. The second condition in order to qualify for the tax relief to be discussed below is that if the person was absent from Switzerland as described above, for more than 10 years, during the 10 year absence from Switzerland, the individual must not have developed any professional activity in Switzerland while abroad. This tax relief is often viewed as a retirement tax relief.

Under available lump-sum taxation, the taxable basis is the cost of living in Switzerland and abroad, i.e., the taxable income itself is not the tax basis. In practice, the taxable living costs are subject to negotiation with the competent state tax authorities; however, expenses for food and clothing, housing, employees, leisure, vacations, cars, boats etc. are usually included.

Furthermore, the state tax authorities require that the amount of tax payable must exceed the income tax which would be due on certain Swiss source income such as income from real estate situated in Switzerland or other financial assets invested in Switzerland or income from intellectual property rights applicable in Switzerland. Also, the tax on foreign source income for which a partial or total reduction of foreign taxes is requested under a tax treaty must also be higher. This comparative calculation must be made on an annual basis.

Absence of Inheritance Taxes

On the federal level, there is no tax on inheritance. On the state level, there are more and more cantons which renounce the levy of inheritance or estate taxes. Currently, the canton of Schwyz does not have any inheritance tax and other cantons such as Zürich have recently abolished inheritance tax for children or other descendants, which opens interesting tax planning opportunities.

Employee Participation Programs

Employee participation programs have become overwhelmingly popular in Switzerland. In particular, companies seeking a stock quotation in Switzerland or elsewhere are usually confronted by financial analysts asking whether the company has a stock plan or a stock option plan at least for its management. Stock and stock options are increasingly issued by privately-held companies too.

An interesting tax planning opportunity in Switzerland is that both stocks and stock options are usually taxed when granted and not when exercised. Accordingly, any subsequent increase in value is usually considered a tax-free capital gain for individual taxpayers. In addition, there are various discounts available if the stocks or stock options are vested for a certain period of time, which further reduces the income tax burden.

Immigration

Current Legislation

a. Self-Employment

Professionals seeking a self-employed professional activity are still subject to considerable immigration barriers since the work permits discussed below - with the exception of the C-Permit - are all issued only in connection with employment through an established employer. A foreign entrepreneur can establish a legal entity - a share corporation or a limited liability company, for instance - which itself employs the entrepreneur, though the particular requirements vary from state to state in Switzerland. There are many rules regarding such a proposal. Most notably, it is important to recognize that minority shareholdings are accepted in most states, i.e., where an entrepreneur holds, for instance, a 10 percent stake in a corporation and is at the same time employed by that corporation, such a situation may entitle the entrepreneur to a work permit. In such a case, additional shareholdings would be subject to individual negotiation with the state immigration authorities. In other words, the state immigration authorities have some discretion in deciding a particular case, and the states have the tendency to construe immigration laws in a more liberal way in order to attract foreign businesses that will benefit the citizens of its state.

b. Employment

Professionals seeking employment in Switzerland can apply for three types of working permits: (a) the so-called 120 Day Permit, (b) the B-Permit, and (c) the C-Permit.

The *120 Day Permit*, as the name implies, allows a foreign employee to work and live in Switzerland for an aggregate of 120 days per annum in Switzerland. It is renewable on an annual basis (for instance, supervising a Swiss subsidiary temporarily or for a limited period of time). There are no quotas for the 120 Day Permit.

The *B-Permit* is a working and residence permit which allows a foreign employee to live and work

in Switzerland for a period of 1 year. Beside the 120 Day Permit, a foreign employee usually starts working in Switzerland with a B-Permit. For this kind of work permit, there are quotas both on the state and federal levels, and in order to receive a B-Permit, a quota must be available. A quota can be used if an employer can prove that (a) no comparable domestic worker is available and (b) that the employment of the particular foreigner is to the benefit of the local state economy. However, and this is an important exception, B-Permits issued in connection with so-called intracompany transfers of higher management are quota-free.

A B-Permit is valid only for a particular state and particular employment, i.e., any change of residence from one state to another state or a change of the employer requires a renewed application. Family members of B-Permit holders may come to Switzerland, however, their employment depends again on the issuance of a separate working permit issuable only if a quota is available for them as well. B-Permits are usually renewed every year.

The so-called *C-Permit* is also called the Swiss "Green Card". It allows a foreign employee to work and reside in Switzerland for an unlimited period of time. A C-Permit also allows self-employed business activity. The change of residence from state to state within Switzerland is possible under a preferential treatment and changing employers is unrestricted.

The issuance of a C-Permit usually requires that a foreigner has lived in Switzerland under a B-Permit for several years. The issuance also depends on the citizenship of the foreigner and on any applicable bilateral treaties. For instance, American citizens qualify for the C-Permit after a period of five years, which is in line with the practice for most European nationals. Prior to the issuance of a C-Permit, there is an examination of the foreigner?s behavior in Switzerland to date.

c. Wealthy Retirees

Wealthy individuals may seek permanent residence in Switzerland. Such permanent residence very often brings the favorable lump-sum tax arrangement described earlier. Wealthy individuals may achieve permanent residence if they (a) are older than 55 years, (b) do not exercise any gainful professional activity either in Switzerland or abroad, (c) transfer the center of their life to Switzerland, and (d) can establish a close relationship with Switzerland.

A close relationship may exist if (a) there are extraordinary cultural or economic benefits that an individual has provided in the past to Switzerland; (b) the wealthy individual has relatives in Switzerland or (c) the individual resided in Switzerland in the past over several years under proven integration.

d. Bilateral Treaty between Switzerland and the European Union

In the last year, Switzerland entered into a bilateral treaty on free movement with the European Union. This treaty has not yet been ratified by a number of European EU-countries but is expected to come into effect by the beginning of 2002. Needless to say, this treaty applies only to foreign employees coming from a EU-member country that ratified the treaty.

During the first 2 years the treaty is in effect, no change in immigration is expected. During the following 3 years, the above described quota system will be alleviated to some extent, i.e., there will be no need to prove that a comparable domestic worker is available; however, a successful working permit will still require an available quota. After that, i.e., 5 years after the treaty has become effective, the quota system will be abolished completely. From then on, no quotas will be required and Switzerland will have only three types of working and residence permits: (a)

Commuters; (b) Short-Term Residents and (c) Permanent Residents.

Foreign Investment in Swiss Real Estate

Overview

Since October 1, 1997, foreign investments in Swiss commercial real estate are no longer limited under the so-called Lex Koller. This liberalization has drastically helped the commercial real estate market in Switzerland, and since then, there has been a tremendous influx of foreign capital and foreign know-how into Swiss commercial real estate business.

Except for foreigners with a C-Permit, who continue to have no restrictions on the purchase of residential real estate, foreign investments in residential real estate are still restricted. Foreigners with a B-Permit may, under certain circumstances and to a limited extent, acquire houses or apartments in Switzerland.

Commercial Real Estate

Before the fall of 1997, the acquisition of commercial real estate in Switzerland was subject to a complex state and federal approval procedure. First of all, it was required that the commercial real estate being sold belonged to a permanent establishment. The foreign acquirer then had to prove that the acquirer was predominantly active in the same field as the permanent establishment, and that the acquirer was willing to control the business unit owning the real estate. Fortunately, all those restrictions have been lifted. Today, even wholly owned foreign capital investments in Swiss commercial real estate are possible without any governmental approval.

If commercial real estate is lumped together to include apartments, such apartments may also be acquired to the extent that they constitute only a minor part of the foreign investment or to the extent that the construction of the apartment was required under applicable zoning laws. Many state and community zoning laws in Switzerland require that the construction of a major office or shopping center include a certain percentage of apartments, and in this context, a foreigner may acquire an office or shopping center together with the apartments.

Another area to be addressed in the commercial real estate arena is land reserves. Land reserves are real estate that has not yet been developed. Such reserves can be acquired by a foreigner if the land reserves do not exceed 50 percent of the overall land lot to be acquired.

A particular complex problem is the acquisition of Swiss insurance companies by foreigners because Swiss insurance companies often have considerable portfolios of residential real estate. As this is a special interest issue, it is only mentioned here and should be closely reviewed if such an acquisition is contemplated.

Residential Real Estate

Foreigners - if they do not have either a B or a C-Permit - are not allowed to acquire residential real estate in Switzerland. Foreigners with a C-Permit may acquire residential real estate without any restrictions.

Foreigners with a B-Permit are still subject to certain limitations. They may acquire an apartment or house if it is to be used as their main residence. As a rule of thumb, they may require residential real estate with dimensions of up to 3’000 square meters without any approval from state or federal

agencies. If a B-Permit foreigner wishes to acquire land exceeding 3'000 square meters, he or she will usually be granted such approval by the applicable state or federal agency if the acquirer can show, based on the particular circumstances of his case, that no capital investment is intended. Such approvals are of course most often requested by wealthy individuals who wish to build large estates.

Once the residential real estate has been acquired, there is no need to sell it if the acquirer leaves Switzerland.

Besides the acquisition of residential real estate as a main residence, foreign persons may acquire residential real estate for purposes of a vacation home or apartment provided that the state in which the individual wishes to purchase the property has available the necessary quotas.

Restrictions on Bank Acquisitions

An acquirer or seller of more than 10 percent of the share capital or more than 10 percent of the voting share rights in a Swiss bank must notify the Swiss Banking Commission (SBC) of such acquisition or disposition. The same notification requirements exist for thresholds of 20, 33 and 50 percent of the share capital or the share voting power. The acquirer must also establish for the SBC that it can secure the Swiss bank?s ongoing solid business conduct. The ability of solid business conduct is evaluated based on the financial situation of the acquirer, its business activities and group structure. Conversely, the Swiss bank itself is required to notify the SBC of any shareholder changes within the above thresholds.

Special notification and permit requirements exist if a foreign acquirer intends to buy or sell shares in a Swiss bank. The SBC approves a foreign acquisition only if the foreign country where the acquirer is registered grants reciprocal treatment. The SBC makes available a list of countries which grant reciprocal treatment. However, the reciprocal treatment list has lost most of its importance due to the WTO/GATS Treaty on Financial Services. If a foreign financial group is the acquirer, the SBC regularly reviews as well whether there is sufficient consolidated supervision.

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