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Law & Tax

**Weil**

# Tax in Distressed Situations **SWITZERLAND**

## GENERAL

### 1. Does debt have a specific meaning for tax purposes?

Debt does not have a specific definition for Swiss tax purposes, which would differ from its interpretation under Swiss commercial law. However, due to the various forms of debt, different Swiss tax implications can arise depending on the specific type of debt, such as loans, bonds, or term notes, including, for instance whether or not the debt and respective interest payments could potentially lead to Swiss stamp duty and withholding tax consequences.

In addition, recent developments indicate that the Swiss tax authorities are increasingly scrutinizing whether intra-group debt qualifies as a loan from an economic perspective, which must be interest bearing. This is particularly relevant for debt receivables at the level of a Swiss entity, as interest income must be recognized in the P&L.

Moreover, detailed regulations and case law exist regarding the reclassification of intra-group debt as equity for Swiss tax purposes (hidden equity as per Swiss thin capitalization rules). Additionally, there are comprehensive rules and guidelines governing the treatment of interest payments on debt involving related parties and debt guaranteed by related parties; see also more under 3.

In addition, a debt can be classified as taxable bond or term note with respective Swiss tax consequences; see in detail under debt refinancing 3.

### 2. Do derivatives have a specific meaning for tax purposes?

There are established guidelines concerning the taxation of derivatives under Swiss tax law. However, there are no specific interpretations of derivatives for Swiss tax purposes.

### 3. Generally, are intra-group debts treated differently to external debt for tax purposes?

Under Swiss tax law, it is essential to distinguish between external debt and intra-group debt, i.e., debt provided by, or to, related parties. It should be noted that, there is no legal definition for the classification of a related party under Swiss tax law; thus, this qualification must be made on a case-by-case basis, considering factors such as ownership, involved individuals, and contractual structures.

Intra-group debts must generally comply with the Swiss thin capitalization rules as outlined in Circular Letter No. 6/1997. The maximum allowable debt financing of a Swiss company is calculated based on the fair market value ("FMV") of the assets. According to the Circular Letter No. 6/1997, a company's debt may be reclassified as hidden equity to the extent that the debt consists of related-party debt and cannot be justified with economic arguments or an arm's length test. To determine the arm's length nature of intra-group transactions, the Swiss tax authorities generally rely on the OECD transfer pricing rules.

In addition, intra-group debt must have an arm's length nature, which includes, taking into account, inter alia (i) proper documentation, (ii) arm's length interest rates, (iii) amount of loan (no cluster risk for lender regarding borrower), (iv) term of loan, (v) borrower's will and capacity to repay the loan, (vi) repayment mechanism, (vii) solvency of borrower, (viii) events of default, and (ix) security. Where no evidenced arm's length interest rates can be provided, the so called safe harbour interest rates as annually published by the Swiss Federal Tax Administration on loans receivable and payables from related parties should be applied.

### 4. Does it make a difference if debt is owed by a partnership or other pass through entity in distress to third parties versus to its partners?

As a general rule, and given that partnerships and limited partnerships are not taxable as companies, the income and gains will be allocated to the general and limited partners. There are specific rules applicable to partnerships or other pass-through entities. These rules also include provisions relating to debt positions of partnerships or pass-through entities and the liability for corporate debts of the partnerships.

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# WEIL CONTACTS

## London



**Jenny Doak**  
Partner, Tax  
London  
+44 20 7903 1060  
jenny.doak@weil.com



**Stuart Pibworth**  
Counsel, Tax  
London  
+44 20 7903 1398  
stuart.pibworth@weil.com



**Anna Ritchie**  
Associate, Tax  
London  
+44 20 7903 1348  
anna.ritchie@weil.com

## United States



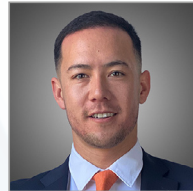
**Devon Bodoh**  
Partner, Tax  
Washington, D.C.  
+1 202 682 7060  
devon.bodoh@weil.com



**Stuart Goldring**  
Partner, Tax  
New York  
+1 212 310 8312  
stuart.goldring@weil.com



**Joseph Pari**  
Partner, Tax  
Washington, D.C.  
+1 202 682 7001  
joseph.pari@weil.com



**Grant Solomon**  
Associate, Tax  
Washington, D.C.  
+1 202 682 7029  
grant.solomon@weil.com

## France



**Edouard de Lamy**  
Partner, Tax  
Paris  
+33 1 4421 1571  
edouard.delamy@weil.com



**Benjamin Pique**  
Partner, Tax  
Paris  
+33 1 4421 9831  
benjamin.pique@weil.com

MEET THE AUTHORS OF OUR JURISDICTIONAL GUIDES

# LOYENS & LOEFF CONTACTS

## The Netherlands



### Bartjan Zoetmulder

Partner – Tax Adviser  
T +44 20 7826 3071  
M +44 7879 607 977  
bartjan.zoetmulder@loyensloeff.com  
*(Currently on assignment in London)*



### Bart Wingen

Senior Associate – Tax Adviser  
T +31 20 57 85 730  
M +31 6 10 89 60 57  
bart.wingen@loyensloeff.com



### Aziza Tissir

Senior Associate – Tax Adviser  
T +31 10 22 46 593  
M +31 6 53 42 48 78  
aziza.tissir@loyensloeff.com



### Jacqueline Kleijn

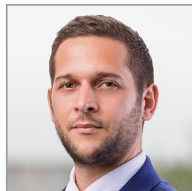
Associate – Tax Adviser  
T +31 10 224 61 66  
M +44 7736 381 775  
jacoline.kleijn@loyensloeff.com  
*(Currently on assignment in London)*

## Luxembourg



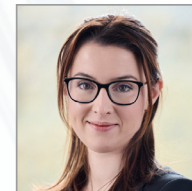
### Pierre-Antoine Klethi

Partner – Tax Adviser  
T +352 466 230 429  
M +352 6 91 96 31 57  
pierre-antoine.klethi@loyensloeff.com



### Kévin Emeraux

Senior Associate – Tax Adviser  
T +352 466 230 570  
M +352 6 91 96 32 24  
kevin.emeraux@loyensloeff.com



### Enxhi Basho

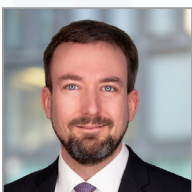
Associate – Tax Adviser  
T +352 466 230 647  
M +352 6 91 96 32 21  
enxhi.basho@loyensloeff.com



### Victoria Hodireva

Associate – Tax Adviser  
T +312 057 853 27  
M +352 6 91 96 31 84  
victoria.hodireva@loyensloeff.com

## Switzerland



### Beat Baumgartner

Partner – Attorney at Law  
T +41 43 434 67 00  
M +41 79 93 06 352  
beat.baumgartner@loyensloeff.com



### Pascal Hammerer

Senior Associate – Tax Adviser  
T +44 207 826 3070  
M +41 79 878 62 03  
pascal.hammerer@loyensloeff.com  
*(Currently on assignment in London)*

## Belgium



### Aldo Engels

Counsel – Attorney at Law  
T +32 2 743 43 92  
M +32 496 13 76 21  
aldo.engels@loyensloeff.com



### Benno Daemen

Senior Associate – Attorney at Law  
T +32 2 773 23 67  
M +32 497 32 99 02  
benno.daemen@loyensloeff.com