burckhardt

Bastian Thurnesen • Rolf Wüthrich

March 2023

Thorny questions in the transfer of branches in Switzerland

Basel
burckhardt AG
Steinentorstrasse 23,
Postfach 258,
CH-4010 Basel

Zürich
burckhardt AG
Usteristrasse 12,
Postfach 1172,
CH-4021 Zürich

burckhardtlaw.com

TAX REFERENCE LIBRARY NO 166

ITR

Published in association with burckhardt

Mergers & Acquisitions

Thorny questions in the transfer of branches in Switzerland

Bastian Thurneysen and **Rolf Wüthrich** of **burckhardt** cut through the thickets of Swiss law regarding the purchase and sale of branch assets under third parties and the tax implications of an intra-group restructuring.

Corporate takeovers are often followed in practice by post-acquisition restructuring measures to include the acquired group in the existing structure and to streamline the organisation for efficiency purposes.

In the case of international groups, complex civil law and tax law issues usually arise in order to implement tax-neutral or tax-efficient restructurings. The situation becomes even more complicated if, in the course of an international restructuring, branches of the acquired group exist which are to be integrated into the acquiring structure and which shall continue their business as new branches of the acquiring group. Special care must be taken for the restructuring of branches in international situations to anticipate and resolve taxation issues in advance.

This article focuses on two questions regarding the restructuring of branches:

- What needs to be considered from a tax perspective when taking over assets and liabilities of a branch, from the buyer's and the seller's viewpoint; and
- What tax problems can arise in the case of an intra-group restructuring of branches.

Branch fundamentals

When dealing with a branch, the characteristics of a branch should be recalled. In contrast to corporations, a branch does not, under Swiss law, have its own legal personality, but is a business operation that is locally separated from the headquarters, but legally dependent on it, with a certain degree of economic independency. It is like the yolk in an egg. The yolk (branch) is an inseparable part of the egg (company), but is, to a certain degree, a separate part of the egg.

The name of the branch must be the same as that of the company, although additions to the name are possible. From a tax point of view,

it is not the branch that is the tax subject, but the corporation to which the branch belongs. Accordingly, a branch creates limited tax liability as a permanent establishment of a legal entity.

Purchase and sale of branch assets under third parties

If assets of a branch are sold to a third party, such sales take place at fair market value and the hidden reserves attached to the assets of the branch are realised. Accordingly, a positive difference between the purchase price and the book value of the sold assets is subject to corporate income tax. Any loss (a negative difference between the purchase price and the book value) can be offset against profits realised at the main tax domicile or any other secondary tax domiciles (in the case of domestic Swiss relationships).

In international relationships, whether a Swiss loss can be offset against profits of the headquarters abroad must be examined.

As the sale of a branch results in the sale of assets (and liabilities), an asset deal takes place and no participation rights in a subsidiary are sold. As a consequence, possible corporate income tax resulting from the sale is not reduced by the participation relief. If the assets of the branch include a participation of at least 10% that has been held for more than 12 months, then the participation relief is granted for the profit realised from the sale of the participation.

In international relationships, the jurisdiction of the branch has, in principle, the right to levy tax on the proceeds from the sale of the branch. If the branch, in turn, holds assets (real estate, warehouses, etc.) in another third country, the applicable double taxation treaties must be examined to determine which country has the right of taxation.

The buyer's and seller's perspectives

From a buyer's perspective, even if individual assets (and liabilities) of a branch are acquired, tax risks are also transferred to the buyer.

On the one hand, the buyer becomes fully liable for the VAT of the Swiss branch, as no distinction is made between the legal forms from a VAT perspective. The only criterion is whether the company runs a commercial activity. This is usually the case with operationally active branches, which is why the VAT history of the branch is also transferred to the buyer. It is advisable to carry out a detailed VAT due diligence to avoid later surprises.

Alternatively, if there is sufficient time, the seller can be required to have a VAT audit carried out by the Swiss federal tax authorities before the sale takes place.

For Swiss tax purposes, it should be further noted that the transfer of Swiss real estate owned by a branch may trigger corporate income tax, cantonal real estate capital gains tax, and real estate transfer tax, if the transfer does not qualify as a tax-neutral reorganisation measure.

While the real estate capital gains tax is generally owed by the seller and the real estate transfer tax is generally owed equally by both parties (depending in which canton the real estate is located), most cantonal tax laws provide for a legal lien for these real estate transaction taxes in order to secure these taxes. As a result, the purchaser of the branch with respect to the real estate may be faced with a charge on the real estate arising from a tax claim against the seller.

If the legal lien is registered in the land register, the tax authorities can satisfy the claim by prosecuting the lien. In such a situation, the buyer usually has no choice other than to settle the seller's tax due and hold itself harmless against the seller. To avoid the adverse consequences resulting from such a situation, it is recommended to agree contractually that any real estate taxes are secured by an advance payment to the competent tax authorities or by involving an escrow agent.

From the seller's perspective, the corporate income tax situation may be optimised by a corresponding tax-neutral group internal pre-deal restructuring.

In a pre-deal restructuring, the branch activity can be transferred by the company to an affiliated corporation in a tax-neutral manner – for example, through one of the two methods described hereafter – allowing a minimisation of the corporate income tax consequences by application of the participation relief on the sale of participations.

Push-down

In the case of a push-down, the assets (and liabilities) of a branch are transferred to a (newly established) subsidiary of the company at book value. The asset surplus transferred can be used for payment or to increase of the nominal capital of the subsidiary and, if not all asset surplus is used for the subscription of the nominal capital, the remaining asset surplus can be booked as a capital contribution reserve. This capital contribution reserve can be repaid to the shareholders without triggering the Swiss 35% withholding tax.

The booking of a capital contribution reserve may, in particular, be attractive in international situations where an applicable double tax treaty does not provide for a 0% withholding tax rate for dividend distributions or where no double tax treaty exists at all.

The disadvantage of a push-down is the triggering of a five-year blocking period. If the pushed-down branch assets or the participation rights in the subsidiary are sold within five years after implementation of the push-down, the transferred hidden reserves are subject to corporate income tax. This anti-abuse rule was introduced to avoid the realisation of a tax-free sale of shares (participation relief) due to tax-neutral pre-restructuring (push-down) shortly before such sale.

In a recent ruling request, a cantonal tax administration concluded that the blocking period was applicable

even if the Swiss subsidiary holding the former branch assets was owned by a foreign shareholder. The administration considered the push-down of the Swiss branch assets of a foreign company into a Swiss subsidiary of such foreign company with a subsequent sale of the subsidiary as a breach of the five-year blocking period, resulting in a taxable event. Accordingly, the described reorganisation alternative of a branch by way of a push-down is only helpful if a waiting period of five years can be accepted.

Spin-off

An alternative to the push-down as pre-deal restructuring is a spin-off of the branch assets and liabilities from the company. Such a spin-off does not create a parent (former headquarters)–subsidiary (former branch) relationship, but a sister (former headquarters)–sister (former branch) relationship with the common parent company.

The prerequisite for a tax-neutral spin-off is that a functioning business unit is transferred and a functioning business unit remains in the demerged company (the so-called dual business requirement). Furthermore, the assets and liabilities of the branch to be spun off must be transferred at book values.

The advantage of the tax-neutral spin-off is that, from a Swiss tax perspective, no blocking period of five years is triggered; i.e., the participation rights of the demerged company can be sold to a third party directly after the demerger. The participation relief is, from a Swiss point of view, granted provided that the selling company held the participation in the subsidiary pre spin-off for at least 12 months and at least 10% of the formal capital is sold.

On the other hand, the asset surplus transferred to the spun-off company cannot be used tax neutrally for the subscription of the nominal capital or be booked as a capital contribution reserve. If a part of the surplus is used for the payment of the nominal capital, the issued participation rights represent free shares, which are subject to income tax or corporate income tax (with possible participation relief). In addition, withholding tax consequences must be clarified. The same principles apply to capital contribution reserves.

In the international context, it must be examined to what extent a spin-off with a subsequent sale of the demerged company can lead to tax consequences in the residence country of the selling parent company, even if the branch and thus the operational business is located exclusively in Switzerland.

As a consequence of the spin-off, the parent company receives new shares in the spun-off company. The question arises as to whether the allocation of the new shares will be considered a taxable event for the parent company (eventually subject to participation relief) or will be a tax-neutral event if, for example, the parent company shows the same total amount of book value before and after the merger; i.e., the shares in the spun-off subsidiary are booked on the level of the parent at a certain amount and the book value of the demerged company is reduced by such amount.

Bastian Thurneysen
Attorney
burckhardt
E: thurneysen@burckhardtlaw.com

Bastian specialises in national and international tax law, with a special focus on Swiss–South African relationships. He advises corporate groups, SMEs and start-ups on all tax issues, in particular on M&A, financing, reorganisations and employee participation plans. He also advises on tax issues in the crypto area and assists private individuals in all tax matters. One of his specialities is conducting tax proceedings, in particular in international tax administrative assistance.

He was admitted to the bar in 2014 and holds a Master of Laws in International Tax Law from the University of Cape Town and a diploma as a Swiss certified tax expert.

Intra-group restructuring

In addition to the sale of branches to third parties, branches are often restructured within the group after they are acquired as part of a takeover. Various options exist to implement such a group internal transfer.

A branch fulfilling the requirement of a functioning business unit can be transferred within a group to a related company (which is directly or indirectly held by a Swiss company) in a tax-neutral manner. The transfer again triggers a five-year blocking period. During this period, the transferred assets may not be sold, nor may joint control be relinquished; otherwise there will be subsequent taxation of the hidden reserves of the branch.

Or, as described above, a branch can be transferred from one company to a sister company by way of a push-down. After implementation of the push-down, the shares in the subsidiary are sold to the sister company at market value. The capital gain realised would be nearly tax exempt, due to the application of the participation exemption, if applicable (a holding period of at least 12 months). However,

as explained above, the push-down triggers a five-year blocking period. The sale of the participation is considered an infringement of this blocking period and results in the taxation of the hidden reserves existing at the moment of the push-down.

If a foreign headquarters pushes down its Swiss branch assets in a new Swiss subsidiary, the foreign company will be the owner of the Swiss subsidiary. All hidden reserves attached to the branch are transferred to the Swiss subsidiary and the realisation of the hidden reserves will still be a taxable event in Switzerland. In the event of the sale of the assets, it is no longer the branch but the subsidiary that will pay income tax on the realised profit. Thus, Switzerland will not lose any taxation substance.

From a Swiss point of view, it is therefore not understandable that a sale of the shares in the Swiss subsidiary by the foreign entity within the five-year blocking period shall still result in a breach of the blocking period, triggering the taxation of the hidden reserves. The tax administration simply takes the position that the blocking period is a so-called objectified blocking period, which triggers taxation when the blocking period is breached, independently of the (abusive or non-abusive) will of the parties involved.

Rolf Wüthrich
Attorney
burckhardt
E: wuethrich@burckhardtlaw.com

Rolf is an international tax lawyer whose areas of expertise are national and international tax planning; inbound and outbound transactions, especially between the US and Switzerland; corporate restructuring and acquisitions; and general corporate secretarial services. He is specialised in drafting and coordinating the implementation of group internal restructuring.

Spin-offs

To avoid the five-year blocking period, the branch can be spun off into a new company. From a civil law perspective, a corporation must be established as a first step, to which the assets (and liabilities) of the branch are transferred in an asset deal. The participation rights in the spun-off company are then sold to the acquiring related company at market value. The profit realised on the sale is (nearly) tax exempt due to the application of the participation relief.

After the sale to the related company has taken place, the spun-off company can merge with the acquiring related company (a parent–subsidiary merger) in a tax-neutral manner. As a consequence, the branch is transferred to another related company without triggering income taxes (subject to the condition that the participation exemption applies).

Evaluating different approaches

From a Swiss perspective, the above three-step procedure (spin-off, sale and merger) is work and time intensive and absorbs internal and external capacities, resulting in considerable expense. From an economic point of view, the same result can be reached if the assets (and liabilities) of the branch are transferred to the acquiring related company by way of a capital increase. The nominal capital issued by the acquiring related company in the course of the capital increase is allocated to the parent company of the transferring company as compensation for the transferred assets and liabilities of the branch. By subsequently selling the newly issued shares to the parent company of the acquiring related company, one has the same structural result as in the aforementioned three-step procedure.

As an economic approach is applied under Swiss restructuring law, the starting point and the end result of both alternatives are the same. It is consequently justified, from a civil law point of view, to implement the simpler alternative in a tax-neutral manner to reach the same result as would be reached tax neutrally with the more complicated alternative.

The economic approach – i.e., to consider the start and end point, and not the individual steps from the start to the end – is an important element for tax neutrality under Swiss restructuring law when planning reorganisations. Economic interpretations can, however, also be understood differently by the parties involved. Therefore, it is always recommended, from a Swiss perspective, to have reorganisation plans and reorganisation steps based on economic interpretation approved in advance on the tax neutrality in a tax ruling.

Finally, if the Swiss branch is held by a foreign corporation, the tax consequences of such Swiss reorganisation must also be clarified at the level of the foreign parent company. In addition, it should be ensured that the selling parent company can apply the participation relief to the sale of the shares issued by the acquiring company.