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Background

For tax purposes, debt securities are a relatively unattractive way for Swiss companies to raise money. Under the current Swiss tax regime, the issuance of bonds by a Swiss resident issuer triggers an issuance stamp tax. Further, interest payments are subject to withholding tax at a rate of 35%, and the secondary trading of bonds is subject to a 0.15% security transfer stamp tax if a transfer of the bonds' titles is effected for consideration and a Swiss securities dealer is involved as a party or an agent to a party to such a transfer.

As a result, the total nominal amount of debt securities issued by Swiss corporations is relatively small in comparison with other European countries and particularly with the United States.

Back in September 2010, the Swiss Federal Government proposed to abolish the issuance stamp tax as part of the «Corporate Tax Reform III» package. The purpose of this package is, *inter alia*, to provide alternative financing for asset-based lending to Swiss companies and to strengthen Switzerland as a domicile for holding companies of international corporate groups. The abrogation of the issuance stamp tax has now become part of the Banking Act Reform Bill that regulates banks that are too big to fail (TBTF) in order to mitigate insolvency risks. As of the publication date of this newsletter, both the first and the second chamber of parliament have voted in favour of the Banking Act Reform Bill. It will now be published in the Swiss Federal Gazette and come into force after the expiration of the deadline for the calling of the facultative referendum. How the new rules on TBTF banks and the abolition of the issuance stamp tax are linked with each other will be discussed below.

Current Swiss Issuance Stamp Tax Act

Under the current Swiss Federal Stamp Tax Act, the issuance of bonds by a Swiss resident issuer is subject to the Swiss issuance stamp tax on the principal amount. An issuer is deemed to be a Swiss resident company if it has its statutory or legal domicile in Switzerland or if it is registered as a branch in the domestic commercial register.

The definition of «bonds» in the stamp tax legislation is broader than the one in securities legislation. It also exceeds the scope of what is considered as a debenture in the trading and banking businesses. According to the rules applicable for Swiss stamp tax purposes, loan debentures (*Anleihensobligationen*) and cash debentures (*Kassenobligationen*) must be differentiated.

A *loan debenture* is deemed to exist if there are more than 10 creditors – Swiss banks (within the meaning of the Swiss Federal Banking Act) and foreign banks (within the meaning of the banking legislation in effect at their respective place of incorporation) not being taken into consideration –, the loan amount is at least CHF 500,000, and there are identical loan conditions referring to just one loan agreement (including syndicated loans). The «identical conditions test» is satisfied if the debt instruments are linked together through uniform terms of interest, term, and repayment conditions or because of other circumstances under which they appear to form part of one debenture.

Cash debenture means the raising of money from more than 20 creditors – with Swiss banks and foreign banks again not being considered – against the issuance of a recognition of debts on a continuous basis on differing terms. As with the loan debenture, the aggregate principal must be equal to or in excess of CHF 500,000. However, a cash debenture does not require that the debt instruments be issued at identical terms and conditions. According to the practice of the Swiss Federal Tax Administration there are three different classes of creditors: creditors of debentures with a term of at least 12 months, creditors of cash debentures including money market book claims, and creditors of collateral/guarantee securities. The creditors in each class are counted separately. If the number of creditors exceeds 20 in one of those classes, the requalification as cash debentures applies only to that particular class.

Since a revision of the Swiss Federal Stamp Tax Ordinance, which became effective on 1 August 2010, debts between group companies do not qualify either as loan debentures or as cash debentures and therefore – provided that the Swiss company does not act as a guarantor under a bond issuance or a syndicated loan towards a respective foreign group borrower – do not count towards the thresholds mentioned above. Only a downstream guarantee to a foreign subsidiary should lead to a requalification according to the practice of the Swiss Federal Tax Administration. In particular, cash pooling structures may benefit from this revision of the Swiss Federal Stamp Tax Ordinance.

The applicable issuance stamp tax rates on the issuance of loan and cash debentures are 0.12% (for loan debentures) and 0.06% (for cash debentures) of the par value for each year of the maximum term of the loan. With respect to money market papers, i.e. bonds with a maximum term of 12 months, a stamp tax in the amount of 1/360 of 0.06% of the face value is due for each day until legal maturity. It is noteworthy that the issuance of equity capital is charged at an even higher rate of 1% on the value of the shares exceeding CHF 1 million. Therefore, the issuance of shares rather than debt instruments for raising money is, from a cost perspective, not a viable alternative.

Banking Act Reform Bill Includes Abolition of Issuance Stamp Tax

In December 2010, the Swiss Federal Government proposed a Banking Act Reform Bill in the context of the TBTF discussion regarding systemically important banks. This bill basically requires systemically important banks to hold more capital, meet more stringent liquidity requirements, improve their risk diversification, and provide for an organisational corporate structure which would allow an orderly winding-up in case of insolvency.

In terms of risk-weighted assets, the Banking Act Reform Bill requests Swiss TBTF banks to hold an equity capital of at least 19% of the risk-weighted assets. 9% of such assets may consist of contingent convertible bonds issued on the capital market. To cushion the costs of the TBTF banks resulting from these very stringent capital requirements, the new legislation will abolish the issuance stamp tax for: (i) the participation rights stemming from the conversion of continent convertible bonds; and (ii) for the issuance of any loan and cash debentures in general. The latter will apply to all issuers, not just TBTF banks, in order to avoid any competitive distortions between TBTF banks and other financial and non-financial institutions with respect to fund raising. The Banking Act Reform Bill will thus enable all kinds of Swiss companies to finance themselves on the bond markets at much lower costs than is currently the case.

There is a further reason why we welcome the abolition of the issuance stamp tax: The more stringent capital requirements will increase the costs of the TBTF banks' lending businesses. In a syndicated loan transaction, the TBTF banks will most likely pass on these costs to the borrower while enhancing the interest rate. The abolition of the issuance stamp tax is, therefore, to some extent only a compensation for the borrowers as it makes raising money on the bond market a valid alternative to asset-based lending.

The new legislation is scheduled to become effective either in February or March 2012 according to the State Secretariat for International Financial Matters SIF.

Trends and Outlook

The proposed abolition of the Swiss issuance stamp tax on bonds along with the favourable legal and regulatory environment on bond issuance and placements that already exists for both Swiss and foreign issuers may stimulate the Swiss bond market in the near future. The financial crises and the tighter regulation of the financial sector have recently forced the Swiss TBTF banks to implement covered bond programmes (backed by Swiss residential mortgages) and one of the two big banks has recently issued a CHF 6,000,000,000 contingent convertible bond qualifying as tier 1 buffer capital notes under the Basel framework. We expect that the Swiss bond market will greatly benefit from the abolition of the issuance stamp tax and that the banks' aforementioned bond issuances only presage a positive trend on the Swiss bond market.

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