Swiss Thin Capitalization Rules

The Swiss Federal Tax Administration issued a circular letter on 6 June 1997 on the criteria for hidden equity capital. For purposes of the federal direct tax, the letter lays down detailed thin capitalization rules for the first time. The total debt provided by shareholders or affiliated parties should not exceed the aggregate (market) value of the following assets of the company, as the case may be, reduced by the total interest-bearing debt capital from independent third parties (such as banks) at the end of the year:

- 100 % of cash;
- 90 % of Swiss and foreign bonds issued in Swiss Francs;
- 85 % of loans and advances, receivables on supplies and services and other receivables;
- 85 % of inventory;
- 85 % of other current assets;
- 80 % of foreign bonds issued in foreign currencies;
- 70 % of participations (shareholdings representing at least 20 % of the capital of another corporation or a fair market value of at least CHF 2 million);
- 60 % of Swiss and foreign shares listed on a stock exchange
- 50 % of other shares/investments in limited liability companies;
- 70 % of operating real estate;
- 70 % of private real estate, holiday homes and zoned land;
- 80 % of other immovable property;
- 50 % of machinery and equipment;
- 0 % of expenses for incorporation, increase of capital and organization; and
- 70 % of other intangible assets.

As a general rule, finance companies may have a maximum debt-to-equity ratio of 6:1, whereas holding companies are subject to the above-mentioned debt-to-equity financing rules. These rules can be overruled by an arm's length assessment. The excess debt finance is deemed to be equity if it is provided by a shareholder or someone close to him or if it is guaranteed by such a person while being provided by a third party. Interest on deemed equity is not deductible for corporate income tax purposes and, in addition, subject to 35% withholding tax (qualification as constructive dividend).