



## **M&A transactions: Hidden profit distribution. A simulated loan issue at the level of a Swiss target company could trigger adverse Swiss tax consequences for the buyer.**

A taxpayer had a debt to a Swiss limited liability company/GmbH held by him, for which the cantonal tax authorities had refrained from claiming a personal taxable income under certain conditions communicated in writing and accepted by the taxpayer. The taxpayer/borrower subsequently breached these conditions with the result that the cantonal tax authorities qualified the loan receivable as a simulated loan. The cantonal tax authorities justified its qualification solely by relying on this agreement with the taxpayer, without examining the existence of the relevant conditions for the assumption of a simulated loan at the time of claiming a dividend income subject to personal income tax at the level of the taxpayer. This approach is questionable not least because the taxpayer sold its shares in the Swiss GmbH to a third-party buyer in 2021 and the purchase price was almost completely offset by the buyer by assuming the seller's loan payable/debt to the Swiss GmbH. The Zurich tax appeals court partially upheld legal remedy by the taxpayer against the appeal decision of the cantonal tax authorities and referred the case back for clarification of the facts.

Simplified, as per Swiss tax law and practice, hidden profit distributions (i.e. non-cash benefits/benefits in kind to shareholders and related parties) are always to be assumed if a Swiss company receives no or no equivalent consideration, the shareholder receives a direct or indirect benefit that would not have been granted to a third party under the same conditions. The benefit is therefore unusual in this respect and the nature of this benefit was recognizable to the company bodies. The reason for such benefits does not lie in the business activities of the company, but in the shareholding relationship. By granting non-cash benefits, the company is not fulfilling a business obligation, but is using available earnings in the interests of its shareholders.

The granting of a loan in the knowledge that repayment may be waived is regarded as a simulated loan. The criteria for a simulation may include: The amount of the loan in relation to the borrower's equity, the non-payment of interest on the loan or its addition to the capital, the lack of connection between the granting of the loan and the statutory purpose of the lending company, the use of the loan for private expenses, the lack of creditworthiness of the debtor, the lack of collateral and provisions on the repayment of the loan, the lack of actual repayment of the loan, the ongoing increase in the debt amount, the lack of profit distributions, the lack of a written loan agreement and a bulk risk for the company granting the loan. A Swiss company and shareholder may disprove existence of a simulated loan.

In the present case, it is disputed whether there was an intention to repay the loan or whether it was to be classified as subsequently simulated and was to be claimed as dividend income subject to Swiss personal income tax at the level of the taxpayer. The Zurich tax appeals court partially upheld legal remedy by the taxpayer against the appeal decision of the cantonal tax authorities and referred the case back for clarification of the facts.

A simulated loan issue embedded in a Swiss target company may result in depreciation expenses being disallowed for Swiss corporate income taxes at the time of impairment of such loan receivable. In addition, adverse Swiss withholding taxes of up to 54% plus late interest of 4.75% could be triggered. Therefore, a thorough tax indemnification is crucial in M&A transactions as well as careful planning of the finance and acquisition structure.

Grant Thornton Switzerland is well-positioned and has in-depth knowledge and experience in advising throughout the transaction and deal cycle, including negotiating tax-clauses of share purchase agreements as well as advising on tax-efficient finance and acquisition structures.



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