
Switzerland

Financial Assistance

IBA Corporate and M&A Law Committee 2022

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INTRODUCTION

This guide shall provide an overview of the Swiss legal framework on financial assistance regarding private limited liability companies (*GmbH; Sàrl*) as well as private and public stock corporations (*AG; SA*).

This guide describes the rules and precedents as in effect at **31 March 2022**.

This guide does not constitute legal advice and the information in this guide cannot substitute professional legal advice. Therefore, anyone involved in financial assistance matters relating to a Swiss company should seek specialist legal advice.

GENERAL OVERVIEW

- **What is the regulatory framework with respect to financial assistance in Switzerland?**

Switzerland does not have any specific regulation of financial assistance. Furthermore, there is only little specific case law addressing issues of financial assistance. The various forms of financial assistance granted or received by Swiss companies must rather be examined in each case in the light of certain restrictions and conditions imposed by general principles of Swiss corporate law, as it is enacted in the Swiss Code of Obligations (CO), and of Swiss tax law. In certain (exceptional) circumstances, financial assistance may also fall under certain specific bankruptcy law provisions and/or constitute a criminal offence under the Swiss penal code.

- **What is generally understood as financial assistance under Swiss law?**

As there is no specific regulation of financial assistance, the term is not defined in any Swiss legal statute. In general terms, financial assistance is broadly understood to encompass any form of a direct or indirect provision of inter-company loans to, or the granting of guarantees, pledges or other security securing the obligations of, any affiliate company. More specifically, the participation of a Swiss company in a group-wide cash pool system is considered to be a specific example of financial assistance. Under Swiss law, the primary legal focus is on *up-stream* (provision of financial assistance from a company to its direct or indirect shareholders and/or parent companies) and *cross-stream* (provision of financial assistance from one group company to any of its affiliates other than its subsidiaries) financial assistance, whereby the granting of loans and securities *down-stream* (provision of financial assistance by a parent to any of its subsidiaries) are from a legal point of view of less concern. However, in a decision of the Swiss Federal Supreme Court a board member of a parent company was held liable for granting a loan to a subsidiary in extreme financial difficulties. So even in *down-stream* circumstances, there are limits to what is permissible under Swiss law.

- **Is financial assistance permissible under Swiss law?**

Under the Swiss legal principle of freedom of contract, the provision of financial assistance is generally allowed, however with stringent and far-reaching limitations imposed by

various general corporate, tax, bankruptcy and even criminal law principles and restrictions.

In the absence of clear-cut statutory law and only little guidance from the courts, it is often difficult to assess whether and to what extent the said general Swiss law restrictions and limitations apply in a given case and whether they have been complied with. However, in a landmark decision in 2014 the Swiss Federal Supreme Court did for the first time clarify some questions concerning financial assistance and in 2019 further developed its practice regarding financial assistance. Nevertheless, many essential questions still remain unanswered. As a result of this uncertainty, and given the potentially harsh consequences of non-compliance, the directors and officers of a Swiss company must carefully analyse the specific facts of each case at hand, before providing financial assistance.

■ **Which are the consequences of providing financial assistance?**

- Corporate law: The provision of financial assistance in violation of the said limitations and principles, and possibly any further acts derived therefrom, may be considered null and void by operation of law. In addition, the directors and officers responsible for the financial assistance may become personally liable for any damage incurred by the company or by third parties.

Furthermore, according to the Swiss Federal Supreme Court, free equity in the amount of any up-stream or cross-stream loan not being at arm's length must be blocked and does to that extent not permit any dividend distributions to be made for as long as such loan remains outstanding and continues to not be at arm's length.

- Tax law: The provision of financial assistance in violation of the relevant limitations may also result in severely adverse tax consequences for the companies concerned, and possibly also for their directors and officers.
- Bankruptcy and criminal law: The provision of financial assistance may in extreme circumstances constitute fraudulent conveyance under the Swiss bankruptcy law and in addition be a criminal offence under the Swiss penal code.

SWISS CORPORATE LAW RESTRICTIONS TO FINANCIAL ASSISTANCE

Cross-stream or *up-stream* financial assistance by a Swiss private limited liability company (*GmbH; Sàrl*) or a private or public stock corporation (*AG; SA*) is only permissible subject to several conditions and restrictions imposed by Swiss corporate law, the most relevant of which are outlined in some more detail below.

It is important to note that Swiss corporate law does not generally recognise the legal concept of a consolidated group of companies (*Konzernrecht*). As a consequence, the decision to provide financial assistance must not be taken on a consolidated view, focusing entirely on the overall interests of the entire group of companies. Rather, the financial status of the Swiss company must first be assessed and secured primarily on a stand-alone basis, focusing on its distinct identity and status as a separate and legally independent Swiss corporate entity.

- **‘Arm’s length’ principle as a general rule of guidance**

Like any other intra-group dealings, financial assistance provided by a Swiss company must generally be at arm's length, ie, it must be granted in an amount and on terms based on which an objective unrelated third party (eg, a bank) would also be ready to grant the same loan or security under the given circumstances. Without setting a clearly specified standard for determining whether or not a shareholder loan is at arm's length, the Federal Supreme Court held for example, in its 2014 decision, that the inter-company loans in question were not at arm's length essentially due to the absence of security and the alleged failure of the lender to address the borrower's solvency at the time the loans were granted.

- **Company purpose**

In order to avoid the risk that the provision of financial assistance would be deemed *ultra vires* and thus null and void from the outset, the corporate purpose provision of the articles of incorporation of the Swiss company should explicitly include the granting of financing to other group companies. In addition, it is generally advisable to make explicit reference in the purpose provision that the Swiss company is an affiliate of the group of companies concerned.

- **Shareholders’ approval**

For various reasons, it is advisable that the granting of financial assistance be formally approved not only by the managing directors (in case of a limited liability company) or the board of directors (in case of a stock corporation), but in addition also by the shareholders' meeting of the Swiss company.

- **Adequate risk diversification**

The directors and officers of a Swiss company must at all times secure an adequate (at arm's length terms) risk diversification and avoid any undue risk concentration. This principle would be violated, if, eg, the balance sheet assets of the relevant Swiss company mainly consisted of *up-stream* and/or *cross-stream* loans to one or several affiliate companies.

- **Diligent liquidity management**

The directors and officers of a Swiss company must ensure that the company is always in a position to meet its short-, mid- and long-term liquidity needs. A Swiss company granting financial assistance must thus make sure that it has at all times the necessary working capital to carry on its business. Furthermore, it must insist on access to appropriate information and institute a viable monitoring system to assess continually the financial strength and solvency of the recipients of such financial assistance. In addition, it must take precautionary measures to react immediately, if any of its affiliates, in the interest of which financial assistance was granted, is likely to head towards financial distress.

- **Limitation to the free equity**

Unless the financial assistance in question clearly meets the stringent requirements of the arm's length test and all other relevant prerequisites and conditions outlined above, the Swiss company's overall financial assistance exposure must be limited to an amount corresponding to the so-called 'free equity'. As a rule of thumb, free equity may be deemed to be the total equity (as shown in the statutory balance sheet), minus 150 per cent (or, in

the case of a holding company, 120 per cent) of the nominal value of the issued share capital, minus any remaining special reserves, which are not available for dividend distributions.

SWISS TAX LAW RESTRICTIONS TO FINANCIAL ASSISTANCE

The granting of financial assistance by a Swiss company may trigger severely adverse Swiss withholding and income tax consequences, if deemed to be a constructive dividend or to constitute factual liquidation proceeds. In that context, it is worth noting that under certain circumstances the responsible directors and officers of a Swiss company may personally become liable for taxes of the company. In the context of financial assistance, the following three criteria need to be closely monitored from a tax perspective:

- **Interest rate**

If the financial assistance is granted *up-stream* or *cross-stream* with an interest rate lower than arm's length, any difference is considered a constructive dividend. The Swiss Federal Tax Administration publishes what it considers to be arm's length interest rates; they differ from currency to currency and are adapted periodically following market trends.

- **Timely repayment of the loan must be realistic and foreseeable**

Under certain conditions, the tax authorities might characterise an *up-stream* or *cross-stream* loan as a constructive dividend in the entire loan amount. This can be the case if, at the time the *up-stream* or *cross-stream* loan was granted or renewed, the borrowing affiliate was in such a poor financial situation that timely repayment of the loan could not reasonably be expected and that a third party would not have granted or renewed such loan on substantially the same terms and conditions.

- **Factual liquidation**

If an *up-stream* or *cross-stream* loan is not repaid and if that leads to the bankruptcy or liquidation of the Swiss lender, the granting of such loan may retroactively be characterised as having been the first step in liquidating the Swiss lender under the concept of factual liquidation. As a result, not only the amount of the loan in question, but rather the Swiss lender's total net assets, calculated on the basis of the fair market values at the time the *up-stream* or *cross-stream* loan was granted, might constitute factual liquidation proceeds and thus be taxed in their entirety at the withholding tax rate of 35 per cent or even 53.8 per cent (if a gross-up applies, see hereinafter).

CONSEQUENCES OF PROVIDING UNDUE FINANCIAL ASSISTANCE

- **Corporate law**

The provision of undue financial assistance, and possibly any further acts derived therefrom, may be considered null and void by operation of law.

In addition, the directors and officers responsible for having granted undue financial assistance may become personally liable for any damage incurred by the company or by third parties as a result thereof.

Furthermore, according to the Swiss Federal Supreme Court, *up-stream* or *cross-stream* loans (including receivables from intra-group cash pools) that do not stand up to the arm's length test, result in the factual blocking of the free equity in the total amount of such loans. Thus, up to such amount, the free equity must not be distributed as dividends for as long as such loan remains outstanding and continues to not meet the strict arm's length test.

■ **Tax law**

Constructive dividends and factual liquidation proceeds of Swiss resident companies are subject to Swiss withholding tax at source (currently at 35 per cent). Upon request, the tax may be fully or partially refunded to the recipient of the profit distribution. For non-Swiss recipients, such a refund may be granted only pursuant to a double tax treaty between Switzerland and the country of residence of the recipient.

Since the withholding tax of 35 per cent must be withheld at source, the taxable amount may be subject to a gross-up to 100 per cent. As a result, the potential withholding tax liability of a Swiss company and possibly of its responsible directors and officers personally, could amount to as much as 53.8 per cent of the constructive dividend or factual liquidation proceeds.

In addition to those potential withholding tax consequences, losses occurred on non-permissible *up-stream* financial assistance are not deductible in computing taxable income of the lending Swiss company. Any inadequate interest income on *up-stream* loans may result in an add-up of the deemed interest income to the Swiss company's taxable profit.

■ **Bankruptcy and criminal law**

Undue financial assistance by a Swiss company may constitute fraudulent conveyance under the Swiss bankruptcy law.

In addition, financial assistance may also constitute a criminal offence under the Swiss penal code (SPC). Thereby, in particular the following criminal offences must be taken into consideration: embezzlement (Article 138 SPC); disloyal management (Article 158 SPC); harming creditors by diminishing assets (Article 164 SPC); mismanagement (Article 165 SPC); and creditor preference (Article 167 SPC).

The acting directors and officers of a Swiss company may thus be penalised with a fine or even a prison sentence. Under certain exceptional circumstances, the Swiss company providing undue financial assistance may itself become subject to criminal sentence.