

THE "10/20 NON-BANK-RULES"

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Every international business lawyer involved in negotiating lendings in which Swiss borrowers are a party will have come across the 10/20 Non-Bank Rule.

In general, interest payments made by a Swiss tax resident borrower under a loan agreement are not subject to Swiss withholding tax unless the same is deemed to be a bond or a debenture issued by a Swiss borrower which could trigger a 35% Swiss withholding tax charge.

What are "bonds" or "debentures"?

The definition of bonds according to Swiss withholding tax rules is much broader than what is commonly understood as a bond.

Based on the guidelines issued by the federal tax authorities, a syndicated loan is treated as a bond and subject to a withholding tax charge if

(i) a Swiss tax resident borrower of one syndicated facility (providing for identical conditions) owes interest-bearing money of more than CHF 500,000 to more than 10 lenders which are not banks (**10 Non-Bank Rule**) ("true bonds")

or

(ii) a Swiss tax resident borrower under debt relationships with different conditions owes interest-bearing money of more than CHF 500,000 to more than 20 lenders which are not banks (**20 Non-Bank Rule**) ("debentures").

The right of the lender to assign its rights partially or entirely is therefore a key issue and must be drafted carefully.

Although at first sight the 20 Non-Bank Rule appears to have an extremely large scope of application, not every credit counts towards the threshold. For example, the 20 Non-Bank Rule only applies to debts with a fixed amount (which excludes current accounts) and incurred for financing purposes (which excludes accounts receivable).

What about sub-participations

Often the lenders do not assign their rights under a facility agreement to new or additional lenders but enter into sub-participation agreements. Whilst lenders may of course re-finance themselves without thereby impacting the WHT situation, if a lender assigns its exposure under the facility agreement to sub-participants, and especially if the latter acquire a direct claim against the borrower, they may be

counted in for the 10 or 20 Non-Bank Rule in the event that the transferee is not a bank (as defined in guidelines published by the Federal tax administration).

When are current accounts of clients relevant?

Generally speaking, only interest paid by banks being Swiss tax resident is subject to withholding tax. The WHT-regulations however extend the definition of a bank and state that interest on current accounts of clients is subject to Swiss withholding tax as soon as the number of depositors (which are not banks) exceeds 100 and the total debt amounts to at least CHF 5 million.

How is the number of relevant non-bank lenders calculated?

The above mentioned thresholds are to be calculated per category (basket). In other words, if the number of non-bank lenders in one basket exceeds the 10 or 20 thresholds, only the interest payments to lenders of the concerned basket are subject to Swiss withholding tax. According to practice the following baskets must be segregated:

1. "Medium term bonds" with a term of more than one year – maximum 20 non-bank lenders
2. "Medium term bonds" with a term of less than one year – maximum 20 non-bank lenders
3. "True bonds" according to the 10 non-bank rule – maximum 10 non-bank lenders
4. Accounts for collateral security – maximum 20 non-bank lenders
5. Current accounts (no fixed term nor fixed interest rate) – maximum 100 non-bank lenders

The lenders of the different categories are not added together. For example the presence of a bond according to the 10 Non-Bank Lender Rule does not affect the other loans for the purpose of the 20 Non-Bank Rule.

Privilege for intra-group loans (e.g. in the case of cash-pooling)

In an effort to facilitate the implementation of cash-pooling companies in Switzerland, the following relief was enacted: Intra-group lenders do not count as lenders, neither under the 10/20 Non-Bank Rule nor under the 100 current-accounts rule as explained above. This exception does however not apply if a Swiss group company grants a guarantee for a bond issued by a foreign group entity.

As a conclusion, the withholding tax on interest of bonds as defined by Swiss tax rules must be adequately considered when structuring financing involving Swiss borrowers and it is therefore important to include appropriate clauses in facility agreements.

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