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Push-down of Acquisition Debt: Swiss Tax Law Practice

Legal Situation in Switzerland

Generally, mergers in Switzerland may be conducted in a tax-neutral way if (i) tax liability remains in Switzerland, and (ii) the tax values are continued. However, Swiss tax authorities often deny tax effective deduction of interest by merging the acquisition vehicle with the target through the "tax avoidance doctrine". Tax avoidance is assumed when the structure is uncommon, inappropriate or strange (i.e. makes no economic sense), when tax savings are the only reason for the structure and when substantial tax savings result from using the structure. The risk that the tax authorities assume tax avoidance is higher if an acquisition vehicle is involved in the transaction (meaning that acquisition debt will be pushed down via merger of the SPV with the target) than if the acquiring company is an operating company.

Alternative Debt Push-down Strategies

As a result of this practice, alternative strategies have been developed to eschew the tax avoidance doctrine while securing (at least partially) the same goal: tax effective deduction of interest.

Cascade Purchase

Cascade purchases are considered in cases where a complex structure is acquired. The acquisition company acquires only a single company within the target structure, which then in turn acquires another company in the structure, etc. This allows for positioning the bank loans in operating companies, whose assets provide sufficient collateral and it allows for interest deduction for profit tax purposes. However, this method can lead to very complex and impractical final structures. To simplify the structure, a merger of all the companies in the structure is needed (possible problems: loss on merger and adverse balance).

Equity – Debt Swap

After the target company decreases its capital, reserves are distributed to the acquiring company, which in turn repays its acquisition loan towards the bank. The bank grants a loan to the target company, with the target company's assets serving as collateral, leading to the desired situation of keeping the loan and the security package in the same company and enabling a tax effective deduction of interest by the target company. This strategy is negatively impacted by the fact that there is often only a small amount of distributable reserves in the target company. Also, equity rules (thin capitalization) have to be followed as well as cases considered in which an "indirect partial liquidation" is assumed and taxed accordingly (if the target company is held as a private asset).

Conclusion

A merger of the acquisition vehicle with the target company often is not an option after acquiring the target company. Alternative strategies have been developed that strive to achieve the same goal. Which method is suited best for an individual transaction has to be determined on a case-by-case basis.

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