Reminder: the Swiss tax risks of a shareholder loan

In the last few years, we witnessed a much harsher approach in the practice of the Swiss Tax Administration regarding deemed dividends, in particular the requalification of shareholder loans as deemed dividends. Please note that the Swiss Federal Supreme Court recently rendered another decision regarding this topic (2C_896/2018 of 29 August 2019). For this reason, we take the opportunity to remind you which criteria must be taken into account for shareholder loans.

1. Deemed dividend

According to the jurisprudence of the Swiss Federal Court, a deemed dividend is qualified as such if the following four cumulative conditions are met:

i. The company grants a benefit without any consideration;

ii. Such benefit is granted to a shareholder or a related party;

iii. Such benefit would not have been granted in similar conditions to a third party;

iv. The disproportion between the benefit and the consideration, if any, is obvious, and the company could or should have realized the advantage they granted.

Deemed dividends can take various forms, such as: the company covering the shareholder's private expense, an excessive salary, granting a loan to the shareholder. In the latter case, the Swiss Tax Administration may verify that the shareholder loan meets the usual conditions of repayment, termination and guarantee that would be requested from independent third parties. Therefore, when the company grants a loan to a shareholder without any consideration, the Swiss Tax Administration could qualify such operation as a deemed dividend. This is the case when it appears that the loan is not in accordance with the arm's length principle.

1. Simulated loan

While the company is free to contract a loan with its shareholder, certain limits must be respected.

Both when granting a loan to its shareholder and regularly during the period of the loan, we advise to examine in particular each of the following criteria:

- Solvency of the borrower,
- Written loan agreement,
- Sufficient guarantees,
- Reimbursement agreements,
- Compatibility with the purpose of the company,
- Importance of the loan relative to all assets of the company,
- Financing by borrowing (lack of liquidity).

According to the Swiss Federal Court, it is necessary to analyze all the circumstances of the case (2C_896/2018 of 29 August 2019), the lack of one or other of the above criteria does not automatically mean that we are dealing with a simulated loan.

For example, the Swiss Federal Court retains the qualification of simulated loan when repayment of the loan cannot seriously be expected (2C_927/2013). The Swiss tax administration examines the seriousness of the loan as well as the willingness to repay, any interest payments that occurred or not, the compatibility of the loan with the commercial purpose, the amount of the loan, the creditworthiness of the borrower, and if the loan was used to finance private expenses of the shareholder.

In addition, please note that the qualification of simulated loan does not only concern shareholder loans, but also loans granted to close relations, such as persons with whom there is an important economic or personal relationship (RDAF 1997 II 519).

1. Recent Swiss case

To summarize, in its most recent ruling the Swiss Federal court retains the qualification of simulated loans on the basis of the following criteria:

- the loan would never have been granted to a third party on the same terms,

- there is no warranty /guarantee,

- the amount of the loan was approximately 85.50 % of the assets of the company,

- there is no reimbursement plan,

- the borrower had never shown any willingness to pay his debt.

In these circumstances, the Swiss Federal Court found, not surprisingly, that the shareholder loan constituted deemed dividend.

1. Swiss tax consequences

For corporate income tax, the amortization of the loan would not be a deductible expense for the company (Art. 58 para. 1 letter b FITA).

For the shareholder, withholding tax of 35% may be levied on the benefit deemed granted, i.e. on the amount of the simulated loan (Art. 4 para. 1 letter b WHTA).

Moreover, the tax administration could qualify the simulated loan as tax evasion, punishable by a fine. According to the Swiss Federal court, tax evasion is deemed to be committed when there is an irregularity in the accounts (2C_508/2014 ; 2C_433/2016).

For these reasons, we recommend a cautious approach when dealing with loans to shareholders. If these loans do not meet the above criteria, it is perhaps possible, depending on the case, to rectify the situation and minimize the tax consequences, for example by including solid guarantees in the loan agreements, by annual payment of interests (no accrual), by a full repayment of the loan by the shareholder, etc.

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The purpose of this note is to provide you with a general overview of the Swiss tax risks involved with the granting of shareholder loans. It is of course necessary to analyze each situation individually. We are at your disposal for any further information you may have.