PERIODIC LEGAL AND TAX INFORMATION REVIEW

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PRACTICAL ASPECTS OF THE DRAFTING OF SHAREHOLDERS AGREEMENTS UNDER SWISS LAW

While the legal framework of Swiss corporate law only imposes one obligation on the shareholder, i.e. the paying-up of the shares, the judicial relationships between different shareholders are frequently contractually settled through a shareholders agreement. The present article illustrates some concrete and practical aspects related to the drafting of shareholders agreements.

Despite the fact that its legal qualification is still challenged sometimes, the shareholders agreement is generally assimilated to a simple partnership agreement within the meaning of Art. 530 et seq. of the Swiss Code of Obligations, i.e. an agreement whereby the partners combine their efforts, resources or contributions in order to achieve a common goal. The shareholders agreement thus creates a partnership with "corporate" aspects related to corporate law.

In practice, the drafting of a shareholders agreement aims mainly at allowing the parties to set forth the modalities of the management of their relationships that are different from and more complex than those provided for in the legal systems, which often do not respond, in this respect, to the shareholders' wishes.

Therefore, it is useful and important to address the following issues when drafting a shareholders agreement:

- The event of the **death of one of the shareholders**: during the negotiations of the shareholders agreement, even though the parties certainly do not wish to envisage this situation, it is strongly recommended to address this issue. In the absence of a specific regulation in this regard, the shareholders agreement would simply terminate upon the death of one of the shareholders. In order to avoid this problem, the usual provisions in case of death provide either for a so-called continuation clause (the agreement is maintained between the surviving shareholders), or a succession clause (the heirs of the deceased step in on behalf of the latter). In any case, it would be advisable to avoid vague and unclear provisions.

- The agreement should also address the **compulsory execution of the property of a shareholder** (thus also of his shares), for instance by granting the other shareholders an option to purchase the shares of the defaulting shareholder.

- The **position of the company** as a possible party to the shareholders agreement should also be clarified. It is now widely accepted that the company itself may be a party to the convention. However, its participation should be limited to the provisions which do not address prerogatives specifically granted to the shareholders. For the sake of clarity, the agreement could establish a list of the provisions applicable to the company through an appropriate form, in accordance with the following model: "the company is a party to articles …".

- The issue of the **coherence between the company's articles of association and the shareholders agreement** also deserves special attention. Therefore, if specific majorities are provided for in the agreement, they should be mentioned in the articles of association, as far as possible.

- As regards **election provisions** set forth in shareholders agreements, it is worth reminding that they are acceptable as regards their principle, but in the event of breach of these provisions at the time of a vote in the general meeting, the decision made during this meeting shall prevail. It would thus be useful to provide for a penalty clause in the shareholders' agreement, which is an efficient means of ensuring compliance with it.

- To **ensure the composition of the circle of shareholders**, a "right of first refusal" provision, which is close to a pre-emption provision, should be provided. To mitigate the risks of share transfers that breach these provisions, may we remind that it is useful to provide that a third-party custodian will remain the holder of the shares (if they have been physically issued). This third party shall commit to holding these shares exclusively on behalf of a limited circle of shareholders until it is informed by all the shareholders of any modification of this circle.

- The possible **deadlock situations** must be addressed in the shareholders agreement; they must also be the object of ad hoc provisions with the view of avoiding them. In this respect, provisions such as the "Texas shoot out" clause (each Party provides a neutral third party with a tender offer to buy the shares of the other party at an established price; the two tender offers are opened at the same time by the neutral third party and the Party having made the higher offer is obliged to purchase the shares of the other Party which is obliged to sell them at this price) and the "Russian roulette" clause (one of the Parties provides the other with a tender offer for a certain price; the party receiving the offer either accepts it, or purchases itself the shares of the other party at the price offered) are useful provisions.

- It might be useful, even necessary, to add a **non-competition clause** to the shareholders agreement. The Parties would then be able to get as close as possible to what is feasible within the framework of the statutory provisions of a limited liability company, especially when the company has few shareholders associated in a project where their know-how and knowledge of the clients are key elements. Again, it is preferable to associate a penalty clause to the non-competition clause, or even to provide for an option call system with a low predetermined valuation to ensure at least a dissuasive effect, if not to ensure its efficiency.

PERSPECTIVES

Shareholders agreements are increasingly being used. They are drafted in a mechanistic way, sometimes on the basis of a model which could prove inadequate since the concrete situations as well as the parties' objectives may vary considerably. The process of adopting the agreement must therefore be the object of a thorough discussion between the parties in order to clarify and agree on the purposes sought, without fear of addressing the most delicate issues. Even though at the time of the conclusion of a shareholders agreement the parties are in a positive dynamic, it is crucial to provide for exit and dispute resolution mechanisms. Indeed, the shareholders agreement is essentially a long-term agreement which must be able to respond to possible crisis that might punctuate the life of the company and of its shareholders. The drafting of a shareholders agreement being often delegated to a lawyer, the latter should keep in mind that on a daily basis, it will be applied by non-lawyers and that therefore concrete, even illustrative provisions are often welcome. The major challenge of the drafting of a shareholders agreement is to anticipate possible sources of conflict and provide for resolution strategies.

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UNITED ARAB EMIRATES: SPECIAL FEATURES OF THE DOUBLE TAXATION AGREEMENT WITH FRANCE

The tax system of the United Arab Emirates (hereafter UAE) is not similar to the tax systems of Western industrialized nations; in particular, it does not provide for income tax, wealth tax or inheritance tax. In this context, a convention for the avoidance of double taxation is particularly interesting since the rules on the allocation of the taxation right between the signatory States may lead to a total absence of taxation when the right of taxation is granted exclusively to the UAE.

The Agreement on the Avoidance of Double Taxation (Double Taxation Agreement – DTA) concluded with France on 19 July 1989 is characterised by the following features:

AS REGARDS WEALTH TAX (ISF):

Under French domestic law, individuals who are not domiciled in France are subject to ISF (at a marginal rate of 1,50%) on their tangible and intangible assets located in France, including participations in French companies as well as shares/units of foreign companies whose main assets (i.e. more than 50%) are real estate ("Société à prépondérance immobilière").

The provisions of the DTA on wealth tax aim at exempting individuals domiciled in the UAE from ISF, not only on their movable assets (including securities) located in France, but also on their immovable property, provided – as regards the latter – that an amount at least equivalent to the value of this immovable property be invested by the persons concerned in financial investments whose issuers (respectively the borrowers) are either Member States of the European Union (EU) or listed companies of a Member State.

AS REGARDS CAPITAL GAINS

Under French domestic law, capital gains realised by a non-resident at the time of the sale of immovable property located in France or of shares of companies investing predominantly in real estate are liable to taxation in France (at the rate of 33 1/3 % for persons non-resident of a Member State of the European Economic Area, plus social contributions at the rate of 15.5%).

The DTA also assigns the taxation of capital gains on the sale of immovable property or shares of companies investing predominantly in real estate to the place where the properties are located, but limits the concept of "predominantly in real estate" to companies whose assets are composed of more than 80% of immovable property located in France. Accordingly, a resident of the UAE who sells a company established for instance in the UAE whose assets are composed of 75% of immovable property located in France and 25% of other assets (financial investments or immovable property located outside of France) is not liable to taxation on the capital gains realised (neither in France nor in the UAE).

AS REGARDS DIVIDENDS:

Under French tax law, dividends paid by a French company to shareholders domiciled outside of France are liable to a 30% withholding tax ; this tax also applies to profits made by foreign companies through their permanent establishment in France (regardless of the fact that they are effectively distributed or not).

The DTA enshrines the rule of exclusive taxation of dividends in the State of residence of the beneficiary; thus, dividends distributed by a French company to a resident of the UAE are neither taxed in France nor in the UAE.

Moreover, the DTA excludes the application of withholding tax on the "deemed distributed" profits realised in France by the permanent establishment of a company of the UAE.

AS REGARDS PROPERTY INCOME:

UAE-source property income received by an individual domiciled in France is taxable in the UAE (which have set forth a "municipal tax" on residential and commercial rents ranging between 5 and 10%); this income is also taxable in France, but the taxpayer benefits from a tax credit equivalent to the corresponding amount of French tax (which corresponds to a tax exemption in France).

Ultimately, the French resident who is the owner of investment real estate in the UAE is liable to a global tax on his property gains amounting to 5 to 10%.

AS REGARDS INHERITANCE TAXES:
Under French tax law, all movable and immovable assets – regardless of their situation (in France or abroad) – are taxable in France if the deceased was domiciled in France or if the beneficiary (heir) is domiciled in France and has been domiciled in France for at least 6 years during the past 10 years. Conversely, if the deceased and the heirs are domiciled outside of France, only the assets located in France (tangible personal property, real estate, claims and French securities) are taxable in France.

Pursuant to the DTA:

- The right of inheritance taxation lies **exclusively** with the State of domicile of the deceased (the connecting factor related to the domicile of the heir is excluded);
- The only exception to this principle is the taxation of immovable property, which is reserved to the State where the property is located; it is worth mentioning that the notion of immovable property provided for in the DTA provision on inheritance does not mention companies investing predominantly in real estate.

Thus, no inheritance taxes will be due in France on the assets of a resident of the UAE – who dies leaving heirs in France – composed on the one part of movable tangible and intangible property located abroad and in France (paintings, vehicles, participations in French companies, etc.) and on the other part of shares of companies holding immovable property located in France.

No inheritance taxes shall be levied in France on the immovable property located in the UAE held by an individual domiciled in France in his own name before his death.

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The provisions of the France – UAE DTA deserve special attention as regards the analysis of the asset reorganisation of taxpayers – domiciled in one of the two States – who hold assets in the other State or who plan on relocating in that State or on investing in the latter, notably in real estate.

Abu Dhabi's and of Dubai's position in the world economy, their resolve to play a major role not only in their traditional sector – oil for the first, commerce and finance for the second – but also in innovative areas are among the factors contributing to stimulate the exchanges with the UAE.

In this context, the special features of the DTA prove to be significantly advantageous when different options in terms of residence or investments are analysed and compared.

DRAFT FINANCIAL SERVICES ACT AND DRAFT FINANCIAL INSTITUTIONS ACT: THE BEGINNING OF THE LEGISLATIVE PROCEDURE IN SWITZERLAND

On June 27 last, the Federal Counci launched the consultation procedure on the Draft Financial Services Act (FinSA) and on the Draft Financial Institutions Act (FinIA). These texts regulate the supervision of financial establishments and the offer of services and financial instruments. Moreover, they provide for a supervisory regime intended for independent asset managers. The purposes announced are the protection of investors, the equal treatment between market players and the harmonisation between Swiss law and European law.

FinIA aims at regulating the **supervision of all financial market players**, i.e. banks, securities firms, representatives of collective investment schemes, asset managers of collective investment schemes and of pension funds, but also independent asset managers, which to date are not subject to supervision.

FinSA, on the other hand, provides for new **rules of conduct** aimed at financial services providers such as the duty of information in favour of clients and the duty to verify the suitability and appropriateness of the financial services proposed.

The **duty of information** includes rules relating to the content, the form and the timing of transmission of the information to the client. In particular, the services provider must inform its clients of the type of service offered: advisory, discretionary investment management or simple distribution of financial instruments. Moreover, in case of investment advice or asset management, the services provider has the duty to specify if the service is performed independently, if the suitability of the financial instruments is assessed on an regular basis and if a market analysis has been conducted. Financial services providers can designate their services as independent only if they consider a sufficient range of financial instruments offered on the market and if no inducements are accepted from third parties, or the inducements that are accepted are passed on to the clients. Services providers may only designate themselves as independent if they comply with these requirements on a permanent basis.

In case of advisory or discretionary investment management, the services provider has the duty, as under European law, to **assess the suitability** of a service with regard to the client's financial situation, investment objectives, knowledge and experience. As regards other types of services, the provider has the duty to assess the **appropriateness** of the service, account taken of the client's knowledge and experience.

Moreover, the draft FinSA includes **requirements as to the training** of client advisors and their registration, as well as the registration of foreign financial services providers performing their activities in Switzerland, with an *ad hoc* register.

As regards products, the FinSA provides that any person or entity willing to offer securities within the framework of a public offer or seeking the admission of securities for trading on a trading platform has the duty to **publish a prospectus**. The prospectus, whose content is set forth in the law, must be verified before it is published by an external supervisory body independent from the FINMA but being duly authorized by the supervisory authority.

Finally, the FinSA includes new rules related to the **enforcement of civil-law claims brought by clients**. Thus, the FinSA grants the client the right to be provided at all times with a copy of its file. Moreover, the client may submit a dispute with a services provider to an ombudsman in mediation proceedings. The private client having submitted its dispute to an ombudsman may then file a claim with the arbitral tribunal, which allows the settlement of the dispute in a single instance. In this event, the client may also request that its procedural costs be borne by a fund for procedural costs – created by the FinSA – in case of dispute related to financial services.

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There is no doubt that the draft FinSA and FinIA bring major changes to the regulations on services providers and on financial services in Switzerland. Even if at this stage they are only draft laws which shall still be approved by the Federal Chambers and specified by an implementing ordinance, these texts reflect the clear desire of the Federal Council to improve the protection of investors. The enforcement of these laws would represent a considerable financial burden, in particular for smaller structures such as independent asset managers.

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FRANCE: NEW OPPORTUNITIES FOR DONATION-SALE OPERATIONS

In a recent decision, the French Council of State clearly established the conditions governing donation-sale operations, creating new opportunities for the structuring of such operations.

In France, the sale of movable or immovable assets is in principle subject to taxes on capital gains.

Once the sale is made and the tax on capital gains is paid, the balance of liquidity resulting from the sale, transferred for no consideration by the seller, notably to his children, are then taxed a second time, this time on the donation (gift tax).

Taken together, these two successive taxes may result in a tax burden on the "sale-donation" up to 80%.

In order to address this fiscal disaster, practitioners have been advising, for many years already, to **revert the chronology** of these operations and to set up an operation of donation of the assets followed by the sale of the latter by the donees.

Indeed, the articulation of the operations in this sense would trigger the payment of gift taxes on the gift in accordance with ordinary law, i. e. in direct line a tax burden between 20% and 45% (depending on whether the gift taxes are borne by the donor or not).

However, it would allow the donee to immediately sell the assets received free of taxes on capital gain. In fact, the previous donation, duly taxed, will have allowed to increase the acquisition price of the assets sold, completely neutralising the capital gain value, which corresponded to the difference between the input value and the output value of the assets of the seller.

By simply reversing these operations, the tax burden on this type of operations may be reduced by almost a half, i.e. around 40%.

In order to further optimise this tax burden, it is also perfectly possible to provide for the donation of the bare-property to the children, the parents retaining the usufruct of the property donated. In this case, gift taxes will be calculated according to the age of the usufructuary according to the scale provided for in Article 669 of the General Code of Taxes, which would allow once again to considerably reducing gift taxes.

The tax administration does not look favourably at the sale-donation tax optimisation schemes; for more than 20 years, it has regularly been attempting to requalify these operations based on the **abuse of right**, considering notably that the donations made were **fictitious** and aimed exclusively at mitigating the taxation (exclusively fiscal nature).

Hopefully, the Committee on Tax Law Abuse (Comité de l'abus du droit fiscal - CADF) as well as the Courts have regularly decided against the claims of the tax administration.

Thus, the Courts systematically examine if the material element of the donation (the irrevocable and definite dispossession of the donor) and the moral element (the liberal intent) were characterised in the cases submitted.

To counteract this case law too favourable to the taxpayer, the Legislator tried to charge the donor with the tax on capital gains if the latter transferred the assets received through donation within a period of two years (3rd Amending Finance Law for 2012).

However, this time the Constitutional Council censured the draft law in its decision of 29 December 2012.

Finally, on April 9, 2014, the Council of State, the highest authority with regard to direct taxation, has put an end to the debate when it **decided against the administration, in a clear and detailed manner**, on a case where one could question the real intention of the taxpayers. Indeed, the parents had donated the bare property (retaining the usufruct) of shares of companies to their three children, having provided for some restrictive provisions in the deed of gift, i.e. the prohibition for the children to alienate the shares and their duty, at the first demand of their parents, to bring these shares to a holding company created to this effect. The children had then brought their shares to a financial holding company which sold them a short time after they were brought to the company. The proceeds of the sale had been jointly reinvested in securities and capitalisation bonds and the income resulting thereof was to be paid to the parents/usufructuaries. Since the deed of gift had resulted in an immediate and irrevocable dispossession of the donors/parents, it had not been possible to implement the abuse of right procedure, despite of the restrictive provisions on the property, the rapid sequence of operations and the managerial and decision making powers of the donors/usufructuaries provided for in the articles of association of the holding company.

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The decision of the Council of State of April 9, 2014 provides the huge advantage of clearly determining the conditions governing the donation-sale operations. It results therefrom that (i) when a donor is willing to make a donation, (ii) the donation is materialised prior to the sale (despite of the short timescale) and (iii) the donor is definitely and irrevocably dispossessed of his assets, the tax administration is not entitled to requalify the operation, even if substantial agreements have been made between the donor (the parents) and the donees-transferors (the children). Thus, it is now possible to perform short-term donation-sale operations while providing for some agreements between the parties, notably parents and children, so that the parents “keep a hand” on the assets given to their children and be able to ensure a proper management of the assets given as well as of the income and proceeds resulting from the latter. The possibility to provide for inalienability and prohibition of pledge clauses as well as for a specific policy governing the distribution of profits to the parents/usufructuaries in the event of dismantling, or the duty to reinvest in a holding company, etc., are some examples of these agreements.

Contact: Alain Moreau

LA POSTE SUISSE SA MODIFIES THE PERIODS OF CUSTODY OF DEBT COLLECTION AND JUDICIAL DOCUMENTS

As from the 1st of April 2014, if a client of La Poste Suisse SA (hereafter "La Poste") provides the latter with a "Poste Restante Order" for a period exceeding 7 days, all judicial and debt collection documents received during this period will be returned to the sender, apparently without any "invitation to collect notice". This notice shall only be deposited in the receiver's mailbox or post office box if the requested period of hold mail is inferior to 7 days.

THE FICTION OF THE RECEIPT AFTER 7 DAYS

La Poste has amended, effective as from the 1st of April 2014, point 7 of its General Terms and Conditions – "Poste Restante Orders", which provides that "debt collection documents and legal documents are retained for a maximum of 7 days".

Thus, if – further to a Poste Restante Order given by the receiver – the period of mail holding exceeds 7 days, all legal and debt collection documents are returned to the sender, and apparently the receiver is not even informed, i.e. no "invitation to collect notice" is sent to his post office box or to his mail box since, precisely, the receiver gave a mail holding order.

This results in a considerable legal insecurity. Indeed, the clients of La Poste who gave a mail holding order for a period exceeding 7 days risk being notified, fictitiously, of documents of which they were not even able to become aware.

The consequences of the non-withdrawal of legal and debt collection documents are provided in several legal provisions under which, in general, a legal or debt collection document is deemed as served when sent by registered mail if it has not been withdrawn within 7 days at the latest as from the failed attempted remittance of the documents if the receiver should expect to receive this notification.

When a hold mail order has been given to La Poste, the same fiction applies by analogy. Accordingly, the document is deemed as notified on the last day of the seven-day period as from receipt of the letter by the post office of the domicile of the recipient. For example, if the date of receipt is February 7, the document will be deemed as notified on February 14.

In other words, the deadline is not extended when La Poste accepts to hold the mail for a longer period of time, which is typically the case further to a mail holding order.

CONSEQUENCES OF THE NEW PRACTICE BY LA POSTE

Taking into account the new procedure applied by la Poste, and in order to avoid being considered as having been notified of legal or debt collection documents without having even been aware of them, it is strongly recommended to avoid giving a hold mail order for a period exceeding 7 days.

The Swiss Bar Association has already asked that La Poste reconsiders this change of practice or alternatively informs the recipients of the non-withdrawn letter, failing what they will not be aware that they have received the notification of a legal or debt collection document.

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Taking into account the consequences of such a change of practice in terms of the importance of the documents as well as of the number of persons and companies concerned, it is shocking that the clients of La Poste were not better informed of this amendment to their general conditions. Even if La Poste does not consider returning to the previous mechanism, it would be at least advisable that it rapidly implements a system whereby it could inform its clients who have given a mail hold order exceeding seven days of the receipt of judicial or debt collection documents that were then returned to the sender because of this order.

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