Interest rates on shareholder loans

Under Swiss law, interest rates on shareholder loans may not be freely determined as there are several legal provisions which limit the freedom of fixing the interest to be paid on shareholder loans. The bottom line, though, is that interest payments on shareholder loans at a fair market rate are not problematic.

Boni mores

Under Swiss law, lenders and borrowers may in principle freely agree upon the terms and conditions of a loan. This principle also applies to shareholder loans, ie loans granted to a corporation by a shareholder. There are, however, several provisions in different statutes limiting this freedom in respect of the interest rate.

First, there is a general principle in Swiss law requiring the parties to a contract to respect boni mores (guen Sitten). According to article 20 of the Swiss Code of Obligations (CO), a contract violating boni mores is void.

With respect to interest rates, the Federal Supreme Court ruled in BGE 93 II 189 that interest at a rate of 26% violates boni mores. The court held in this case that such an interest rate must be considered exceptional and clearly against the common use and the general understanding of an acceptable interest rate. The court based its analysis on the provisions of the Intercantonal Concordat on Measures to Fight Misuse of Interest Rates (the Concordat), although the Concordat was not directly applicable in this case.
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According to article 1 of the Concordat, interest is capped at a rate of 18% per annum (12% per annum for interest plus 6% per annum for fees and costs). Because the Federal Supreme Court considers the maximum interest rate set out in the Concordat to be a standard basis even if the relevant canton is not part of the Concordat, one can conclude that interest rates which exceed 18% per annum are likely to be considered in violation of boni mores and therefore void.

But although the interest rate is void, the loan itself remains intact if a court assumes that the parties would have concluded the loan agreement with another interest rate had they known about the voided interest rate (see article 20, paragraph 2 CO). The interest rate will therefore be reduced to 18% per annum. For the interest paid at a rate exceeding 18% per annum, the company has a claim against the lender based on unjust enrichment (see article 62 CO).

Special circumstances may, however, justify interest payments at a rate higher than 18% per annum. Such circumstances could be present if the loan is particularly risky, for example, in a start-up or in a work-out situation. In such cases, the parties may agree upon interest at a rate of more than 18% per annum if that rate fulfills the third party test — i.e. if the parties can prove that an independent bank would only grant the loan with interest at that higher rate.

Second, apart from violating boni mores, interest at a rate of more than 18% per annum may also constitute usury (Wucher) according to article 157 of the Swiss Penal Code (PC). In order to violate article 157 PC, there must be an obvious discrepancy between the consideration of the borrower and that of the lender.

With regard to interest rates, the Federal Supreme Court ruled in an unpublished case that the rate of 18% per annum should be the borderline with regard to interest rates. The court accepted, however, that specific reasons may justify interest payments at a higher rate. The basis for comparing the interest rates is the fair market rate. Therefore, interest at a rate of more than 18% per annum is only usurious if it deviates from the market rate.

However, even if there is an obvious discrepancy between the fair market rate and the interest rate at hand, interest is only usurious if the lender exploits a dilemma, dependency, inexperience or weakness of the borrower, i.e. of the company. In the case of a shareholder loan, the company may be in a dilemma if it has an urgent need of cash, especially if the loan would provide the liquidity needed to avoid the initiation of bankruptcy proceedings. On the other hand, the company is not in a dilemma in the sense of article 157 PC if it borrows the loan for a new investment or even to start up a business.

In summary, a specific interest rate is never usurious in the sense of article 157 PC if an independent third party would grant the loan under the same conditions or if the rate is below 18% per annum. Interest rates in excess of 18% and inconsistent with fair market rates may be usurious if the company is in a dilemma. In this case, the agreement about the interest rate would be void under article 20, paragraph 1 CO (cf above).

Hidden dividends

Third, interest payments on shareholder loans must be analysed under corporate law. Under corporate law, interest payments at a rate exceeding the fair market rate may be considered hidden dividends. The fair market rate is the rate at which an independent third party would grant the loan to the corporation under the same conditions. If the interest rate is obviously higher than the fair market rate, the company pays a hidden dividend to its shareholder. The company has the right to reclaim such hidden dividend payments based on article 678, paragraph 2 CO. If the company pays such hidden dividends on the account of the protected reserves or even of the share capital, most authorities conclude that such contract may be void. As explained earlier, only the interest rate, and not the loan itself, is invalid.
Finally, under a tax law point of view it must be noted that the Federal Tax Administration periodically publishes guidelines for the calculation of interest rates on shareholder loans. According to these guidelines, the Federal Tax Administration presently limits interest payments on shareholder loans at a rate of 6.5% per annum in the case of an operative company and at a rate of 6.25% per annum in the case of a holding company.

One must note, however, that these interest rates may be higher if the fair market rate for the loan at hand is higher. If a higher interest rate is agreed upon, one has to prove that an independent third party would have granted the loan only with interest at this higher, agreed upon rate. In this sense, the interest rates published by the Federal Tax Administration may be seen – under the tax aspects – as a safe haven rule, i.e. interest on shareholder loans is never considered to be a hidden dividend if it does not exceed the rates published by the tax authorities.