

# FEDERAL SUPREME COURT RULES ON DEDUCTIBILITY OF INTEREST IN LEVERAGED BUYOUT WITH DEBT PUSH-DOWN

**In a landmark ruling (9C\_606/2025, 24 February 2026), the Swiss Federal Supreme Court has for the first time directly addressed the deductibility of interest following a debt push down in a leveraged buy-out and held that interest attributable to the acquisition financing component of a loan pushed down to the target company through a post-acquisition merger does not qualify as an expense "justified by business use" under article 58(1)(b) Federal Direct Tax Act (FDTA).**

## FACTUAL BACKGROUND

The case concerns a Geneva-based operating company (the "**Target**") whose principal operating asset is a residential property. In 2008, a special-purpose acquisition vehicle (the "**AcquiCo**"), acquired 100% of the shares of the Target for a purchase price of CHF 8.4 million. On the same date, a third-party foreign lender (the "**Lender**") granted a loan of USD 9.5 million (at the time approx. CHF 11 million) to the Target and AcquiCo, jointly and severally, with a dual contractual purpose: the acquisition of the shares in the Target and the renovation of the residential property. The loan agreement expressly required the prompt merger of AcquiCo into the Target.

In April 2009, the Target absorbed AcquiCo through a downstream merger, entailing the transfer of all assets and liabilities and the deregistration of AcquiCo from the commercial register. The Geneva tax authorities economically divided the loan from the Lender into a portion of CHF 8.4 million used for the acquisition of the Target (76.36% of the total) and CHF 2.6 million for the renovation of the property (23.64% of the total) and used this split for the apportionment of interest. It allowed the deduction of interest only in proportion to the "renovation" part of the interest and disallowed any interest deduction attributable to the acquisition debt.

## DEDUCTIBILITY OF INTEREST FOLLOWING THE DEBT PUSH DOWN

### COMMERCIAL JUSTIFICATION AND THE OBJECTIVE CAUSAL LINK TEST

In Swiss tax law, the taxable profit is based on the net income determined in the commercial accounts. Expenses not justified by business use are added back under Article

58(1)(b) FDTA and under the cantonal income tax laws. An expense is justified where there exists an objective causal link between the expense and the enterprise's business purpose, the burden of proving that link falling on the taxpayer.

The Court confirmed the allocations made by the cantonal tax authorities of the Lender's loan into an acquisition part and a renovation part. The renovation share of the debt interest, demonstrably linked to works on the Target's operating asset, is held to be spent for the Target's business purpose and therefore remains deductible. The same does not apply to the acquisition share of the debt interest: the Target's actual business consists solely of operating a property – its financial statements show only real estate assets and furniture but no holding company activity – such that there is no objective causal link between the interest expense on the acquisition portion of the loan and the business purpose pursued by the Target. Generic assertions about future profitability or broad objectives in the Target's articles of association authorizing financial transactions do not suffice according to the Court.

#### **DISMISSAL OF THE TAXPAYER'S ARGUMENTS**

The taxpayer advanced the argument – supported by part of the doctrine – that interest commercially justified at the level of AcquiCo automatically retains that character in the Target's hands following the merger. The Court rejected this argument based on the so-called periodicity principle, which requires that charges be assessed period by period. While a merger results in a universal succession of all assets and liabilities, there is no statutory basis for an automatic "carry-over" of the nature of charges across a merger: deductibility must be assessed afresh for each fiscal period and for each entity as it then exists.

The Court also dismissed the taxpayer's argument that federal case law under article 58 FDTA allows deductibility of expenses if they are commercially justified and intended to generate profit, regardless of strict conformity with statutory purpose. The Court held, however, that the taxpayer has failed to sufficiently demonstrate that there is a link between the interest expense incurred on the acquisition loan and the economic activity carried out by the Target.

#### **APPRECIATION AND PRACTICAL IMPLICATIONS**

A key aspect of the ruling is the Court's reasoning leading to its decision. Cantonal tax authorities have often denied interest deductions after debt push downs on tax avoidance grounds, applying the trifold test of unusual

structure, tax savings motive and effective tax benefit. Such denial was sometimes limited to a five-year period after the transaction.

The argument that a merger after a transaction is "unusual" is regularly challenged in literature and was also questioned in an *obiter dictum* by a lower court, as a merger might often address operational rationales and can be explained by the absence of group taxation.

Several cantonal tax authorities had justified the denial of the interest deductibility not on grounds of tax avoidance but on article 58(1)(b) FDTA, saying that the interest expenses on the acquisition debt are not commercially justified. The Court followed this line of argument, stating that interest expense must be denied if there is no objective causal link between the expense and the business purpose of the surviving entity.

For operating targets with no holding or acquisition function, it would generally be impossible to provide proof of such link, resulting in a straightforward denial of the deduction of the purely acquisition-financing related interest. It remains uncertain from the Court's decision whether a target entity that acts as a holding company and regularly acquires other companies – such as being the parent company of an operating group – would satisfy the requirements specified by the Court.

The Court's reasoning also leaves open whether temporal limitations of the non-deductibility of interest expense applied by tax authorities – often for a five-year period after the acquisition – would remain intact, given that the Court's framework suggests that deductibility should be assessed annually by reference to the surviving entity's actual use of funds.

The decision could further result in certain tax authorities which so far applied a more lenient approach to interest deductibility in cases of debt push-downs to revise their practice and apply the strict criteria of the Court's decision without necessity to justify that there is tax avoidance.

The Court's decision covered only the downstream merger of a pure acquisition company very shortly after an acquisition. It should be noted that such structure could also result in dividend withholding tax consequences where the Swiss Federal Tax Administration treats the transfer of debt as a deemed dividend to the shareholder of the acquisition company. The deductibility of interest in other cases, e.g. an acquisition by an operating entity or other means to reallocate operating income and/or interest expenses within the group after an acquisition is not directly affected by the Court's decision but require a case-by-case analysis also in the light of this decision.



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