Swiss Capital Contribution Principle

Reference: CapLaw-2010-63

As per 1 January 2011 a new regulation in the Swiss tax law concerning the tax treatment of the repayment of capital contributions enters into force. According to the new rules the repayment of capital contributions is exempt from Swiss income tax (if the shares are owned as private means) and Swiss withholding tax.

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1) Overview on the New Regulation

The exemption on taxes for repayment of capital contributions applies to all capital contributions made after 31 December 1996. According to the law and the circular letter published by the Swiss Federal Tax Administration (FTA), very strict formalistic rules and deadlines have to be followed.

All capital contributions made after 31 December 1996 have to be booked into a separate account in the statutory balance sheet and all changes on this account will have to be notified to the tax authorities using a specific new form. Such separate account is the first time requested for the business year ending in 2011. Additionally, the companies have to declare to the FTA the history of the capital contributions since 31 December 1996 and provide them with evidence that the reflected contributions are "true" capital contributions. Such evidence can be provided by filing financial statements, statements of account, stamp duty declarations etc.

The mentioned circular letter is dealing with some general requirements as well as with some specialties requested by the FTA. In the following some main topics are reflected.

2) Qualified Capital Contribution—Contributions from Direct Shareholders

The FTA is very strict in determining the concept of a capital contribution. According to the FTA only contributions from direct shareholders may qualify under the capital contribution principle for the tax exemption. This means that contributions for example from a "grandmother" company or from a "sister" company would not qualify as capital contribution in the sense of the capital contribution principle.

3) Hidden Capital Contributions

Based on the official interpretation of the FTA, only contributions that have been reflected in the financials of the receiving company can qualify under the capital contribution principle. Since hidden capital contributions are not accounted for, such contributions do not count for the reserves from capital contribution and therefore cannot be repaid tax free. Only during the current business year (as long as the books are not yet closed) a hidden contribution can be openly declared and rebooked—without realizing a gain subject to tax. In such case, the contribution will be seen as a qualifying capital contribution and can be repaid tax free if the other conditions are met.

4) Set-off of Losses with Capital Contribution Reserves

Based on the interpretation of the FTA a set-off of losses against reserves from capital contributions is final and can not be revoked. Should the company have accounted losses against qualifying capital contributions in the balance sheet of the company, such set-off is final and reduces the reserves from capital contribution independently on whether in later years the capital contribution reduced by set-off with prior losses is replenished by future profits.

5) Recapitalization

The newly established practice of the FTA mandates a complete set-off (from a bookkeeping as well as tax point of view) of the existing losses with the reserves from capital contribution while granting a release of the Swiss issuance stamp tax in case of recapitalization of the company. This leads to a conflict between the interest of the company to avoid any issuance stamp tax and the interest of the shareholder for a tax-free repayment of the contributions effectively made during the recapitalization. Set-offs against reserves from capital contributions are final and reduce the benefit of a tax-free repayment (see above).

In case of recapitalizations it has to be analyzed accurately what economically makes sense—paying the issuance stamp tax versus ensuring the reserves out of capital contributions. It is recommended to carefully plan the process of contribution during recapitalization.

6) Reorganizations

Certain cases of a tax neutral restructuring result in a five year blocking period. During that blocking period some transactions are prohibited, e.g. the transfer of assets or a sale of the respective participation to a third party. In case of an infringement of this blocking period, the underlying restructuring will be treated as taxable event retroactively and will be taxed at the level of the involved parties. In general such breach of the blocking period leads to the realization of the hidden reserves on the transferred asset(s). Even though the hidden reserves are realized in such event, the step-up in basis in the books of the assuming party does not qualify as capital contribution in the sense of this principle. This could lead to the situation that the retroactively realized hidden reserves will be taxed a second time in the context of the distribution, respectively the repayment of funds to the shareholders.

7) Recommendation

To benefit from the new regulations as well as to avoid any disadvantages, the following measures should be taken:

- Reassessment, whether it would be beneficial to disclose hidden capital contributions during the current year, prior to the approval of the general assembly of the statutory financial statements
- Avoidance of set-off of qualifying capital reserves with losses
- Assessment during recapitalization which option is more favorable from a tax point of view: release of Swiss issuance stamp tax versus the set-off of losses against reserves out of capital contribution
- Identification of all capital contributions after 31 December 1996
- Timely and solid declaration of the reserves of capital contribution, i.e. a systematic schedule of all identified capital contribution after 31 December 1996
- All capital contributions after 31 December 1996 need to be booked in a separate account in the statutory balance sheet
- Systematic planning of future distributions to shareholders (dividends versus repayment of nominal value versus repayment of capital contributions) as well as of share-buy-back-programs
- For future acquisitions of companies the existence and the review of the FTA-declaration as well as the proper booking in the statutory balance sheet will represent an important part in the due diligence process
- Future contributions have to be planned properly, as in certain cases an open-booked capital contribution will be more favorable than a hidden capital contribution

With the new capital contribution principle in force as per 1 January 2011 a long-lasting nuisance will be abolished by no longer qualifying the repayment of contributions, originally made by direct shareholders, as taxable event.

Even though the capital contribution principle seems to be a quite simple concept, the implementation leads to several uncertainties and demands a good and proper planning and implementation to ensure the ability to benefit from the new regulations.

Last but not least, the circular letter published by the FTA forms some sort of safe-harbour-rule but is still only a guideline from the FTA. Differing positions by the tax payer are possible, defensible and may become acceptable after being ruled by court.

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