PrimeTax
Professional Tax Solutions

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Capital contribution principle: Need for action on tax free repayment of contributions to premium

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Change of system

As a result of the change of system from the nominal value to the capital contribution principle introduced on January 1, 2011, capital contributed to premium can now be returned to shareholders free of tax. This applies to the repayment of capital contributions by both domestic and foreign companies.

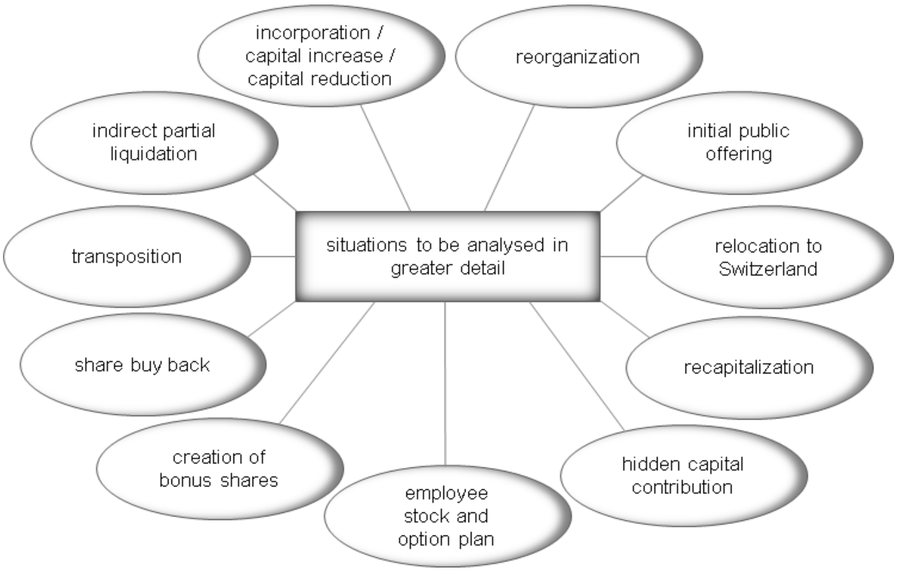
Eligible for the income tax and withholding tax free repayment of capital contributions are only contributions made directly by a shareholder after 31.12.1996 and which have been recorded in the statutory balance sheet of the recipient company on a separate account. In view of the future tax treatment of reserves a distinction must therefore be made between capital contribution reserves repayable tax free and other reserves (e.g. retained earnings), the distribution of which will continue to be subject to income and withholding taxes.

Companies affected

Affected by the capital contribution principle are all Swiss capital companies and foreign capital companies with private shareholders domiciled in Switzerland. The introduction of the capital contribution principle is also relevant for Swiss group companies, because it cannot be excluded that one day an initial public offering will take place or a company will be sold to a foreign shareholder or individual (e.g. Management Buy-Out). Therefore practically all Swiss capital companies are urgently recommended to undertake an early analysis of their existing reserves.

Diverse effects of the capital contribution principle

The equal tax treatment of capital contribution reserves and of nominal (par value) capital impacts various special tax situations, such as reorganization, recapitalization, repurchase of own (treasury) shares, creation of bonus shares, transposition, indirect partial liquidation etc. In particular the following situations will have to be analysed in greater detail:



Such transactions carried out in the past are to be re-evaluated against the background of the introduction of the capital contribution principle and for future transactions interesting tax planning opportunities may arise. The introduction of the capital contribution principle therefore demands a careful analysis of the tax effects of these situations.

Loss set off

In the opinion of the Swiss Federal Tax Administration the set off of losses against capital contributions results in the definitive loss of the capital contributions, i.e. capital contributions made after 31.12.1996 which have been, or are, set off against losses, cannot be returned tax free to shareholders. It is therefore crucial for claiming capital contributions repayable tax free that as far as possible losses are not set off. For tax reasons losses should therefore be reported in the statutory balance sheet gross (negative equity). Recapitalization payments by shareholders (e.g. non-refundable payments) should therefore not be set off against the existing loss carry forward, because in the view of the Swiss Federal Tax Administration this also results in the use of the capital contributions.

Reporting in the statutory balance sheet and disclosure

The recognition of tax free repayable capital contributions made during the period 1.1.1997 - 31.12.2010 requires that in the statutory balance sheet of the financial year, which ends in the calendar year 2011, they are openly reported on a separate sub-account of the legal reserves as "capital contribution reserves" at the latest. A later disclosure of the capital contributions is not recognised for tax purposes and results in forfeiture of the tax free repayment. These capital contributions must be reported and substantiated to the Swiss Federal Tax Administration within 30 days of approval of the annual accounts for the financial year 2011. The report is made using Form 170 and an Excel table prescribed by the Swiss Federal Tax Administration.
Following the ordinary first disclosure the annual accounts are to be submitted annually to the Swiss Federal Tax Administration within 30 days of their approval. In addition all movements in capital contributions are to be reported using Form 170. After reviewing the capital contributions reported, the Swiss Federal Tax Administration notifies the amount to the company concerned.

Dividend resolution
The General Meeting can in future decide whether dividend distributions are to be charged to the capital contribution reserves or the other reserves (provided the Corporate Law restrictions applicable to legal reserves are observed). If the General Meeting's resolution concerning the allocation of the dividend distribution among the various classes of reserves provides no detail, first a (taxable) dividend distribution out of other reserves will be assumed. It is therefore to be noted that a tax free repayment of capital contributions requires a detailed profit distribution resolution by the General Meeting. The allocation of the dividends between capital contributions and other reserves resolved by the General Meeting applies to all shareholders. It is therefore not permissible to distribute dividends falling under the capital contribution principle to individual shareholders and to distribute dividends out of the other reserves to the other shareholders.

Need for action
In order in future to be able to benefit from the tax free repayment of capital contributions, the movement in a company's reserve positions must be analysed each year. In a first step the reserves existing at 31.12.2010 are to be analysed and allocated between capital contribution reserves repayable tax free and other reserves, the distribution of which is subject to income and withholding taxes. This analysis must be completed no later than the end of the financial year 2011. Depending on the number of companies and transactions carried out since 31.12.1996 (e.g. reorganizations, recapitalizations, loss set offs etc.), the determination of the relevant capital contributions may be very time consuming.

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