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Contributed capital challenges cross-border work

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Contributed capital challenges cross-border work

Rolf Wüthrich of burckhardt explains the newly introduced rules of the principle of contributed capital and the impact on cross-border situations.

Switzerland significantly increased its attractiveness as a location for international headquarter and holding companies by implementing the principle of contributed capital (*Kapitaleinlageprinzip*). The principle allows the repayment of contributed capital other than formal capital without triggering Swiss withholding tax and, in the case of Swiss shareholders, income tax free. The principle will apply to any premium payment or contribution into the reserves made after December 31 1996. However, to take advantage of the new rules, bookkeeping and reporting measures are necessary. Even if the reporting deadline for such contributions and premium payments will only be mid-2012, it can take considerable time to identify the relevant group internal reorganisations, the contributions into the reserves, the offset of losses with contributions over the period of the last 15 years to define the contributions qualifying for the new principle.

Contributed capital avoids tax

From January 1 2011, the principle of contributed capital entered into force in Switzerland. As a consequence, fundamental changes occurred under Swiss tax legislation with respect to the repayment of equity contributions and premium payments. Under the old legislation, applicable until December 31 2010, any repayment of equity other than the formal capital registered in the articles of incorporation of a company was considered to be a dividend and, as a consequence, subject to Swiss withholding tax. Furthermore, if the shareholder was a Swiss resident, such a repayment was subject to income tax. The principle of contributed capital puts, for tax purposes, contributions and premiums payments made by the shareholder into the equity of a Swiss company equal to the creation of formal capital in such company. As said, the repayment of such contributions and premium payments is, as it is the case for formal capital, no longer subject to withholding tax and, for Swiss shareholders, also tax free.

The Swiss federal tax administration issued Circular Letter No. 29 "Principle of contributed capital" dated December 9 2010 to give guidelines on how to implement the new principle. The letter confirms that reserves from capital contributions are, for tax purposes, now put equal to formally paid-in capital. On the other side, profits realised in the current tax period, profits carried forward, hidden capital contributions and capital contributions not made by the shareholder are not considered to be reserves from capital contributions and, as a consequence, are qualified for tax purposes as other reserves. Other reserves do not qualify under the principal of contributed capital and are, in case of a distribution, still subject to Swiss withholding tax. It should be noted that contributions made by a shareholder will also qualify as other reserves if such contributions are not shown in a separate equity position as reserves from capital contributions, even if they fulfill all other conditions under the new principle. Any requalification of other reserves into reserves from capital contributions are only accepted within the framework of the rules set out in the letter.

The principle of contributed capital applies to payments from Swiss companies to Swiss and non-Swiss shareholders as well as to payments from foreign companies to Swiss shareholders. Thus, if a Swiss shareholder wants to benefit from the principle of contributed capital a non-Swiss company must render proof that the distributed funds qualify under the Swiss rules as repayment of reserves from capital contributions.

Under the new rules a shareholder is free to decide if a payment out of the equity shall be a repayment of formal capital, a repayment of reserves from capital contributions or a payment out of the other reserves (dividend). A payment can also be combined, partially consisting of formal capital, reserves from capital contributions and other reserves.

The repayment of reserves from capital contributions must be reported separately from a distribution out of the other reserves. If a company does not distinguish between dividend payments and the repayment of reserves from capital contributions, then a payment will in total be qualified as a payment out of the other reserves and, as a consequence, will be subject to withholding tax.

Reorganisations and recapitalisations

The principle of contributed capital offers planning opportunities for future restructuring. Also reorganisations and capital contributions made between December 31 1996 and December 31 2010 should be reconsidered and, if qualifying, be reported to the Swiss federal tax administration to ensure that such contributions can be repaid withholding tax free. Even if under the current structure in place no withholding tax issue might exist (such as because contributions were always made by a parent resident in Switzerland or resident in a treaty country) compliance with the new rules will, for withholding tax purposes, optimise flexibility for future reorganisations involving Swiss subsidiaries in cross border situations.

The circular letter contains explanations for the principle of contributed capital and the most popular reorganisation measures. First of all it states that a contribution of a company into the reserves of a sister company does not qualify as reserve from capital contributions as a sister companies is not a shareholder.

The new principle requires that contributions connected to recapitalisation measures must be offset with realised losses booked in the financial statements. In principle, any capital contribution is subject to Swiss stamp duty of 1% of the contributed funds. In the case of recapitalisation measures or tax free reorganisations, stamp duty is, however, not due. A recapitalisation contribution up to SFr10 million ($10.4 million) is stamp duty free as long as the contribution does not exceed the loss shown in the commercial books. If a stamp duty free recapitalisation takes place, then the withholding and income tax free repayment of such contribution shall not be allowed. The amount of contributions used to set off the loss can therefore not qualify as reserve from capital contributions. Capital contributions exceeding the offset losses are subject to stamp duty, but can, in such amount qualify as a reserve from capital contributions.

In a merger, only the formal capital or an existing reserve from capital contributions in the books of the absorbed company can qualify as reserve from capital contributions in the equity of the absorbing company. When implementing an upstream merger a possible gain realised by the parent company (book value of subsidiary in parents books is lower than absorbed net assets of subsidiary) is considered to be a taxable event and the surviving parent must book such gain in its equity as other reserves. When doing a reverse merger a non-Swiss shareholder will realise a distribution subject to Swiss withholding tax if the merger results in an increase of formal capital held by the non-Swiss shareholder. This means that the Swiss subsidiary absorbing the Swiss parent had a higher formal capital than the absorbed parent. If the reverse merger results in a merger premium for the absorbing subsidiary, then such premium may only be booked as reserve from capital contributions in the amount of formal capital and reserves from capital contributions booked in the books of the absorbed parent company exceeding the formal capital and the reserve from capital contributions booked in the books of the absorbing subsidiary.

In a share to share deal (a company contributes shares in a (Swiss or non-Swiss) subsidiary to a Swiss company against issuance of shares by the Swiss company) the difference between the amount of a possible formal capital increase by the Swiss company and the exchange value (premium) can be booked as reserve from capital contributions in the books of the Swiss company.

When implementing a push down of assets and liabilities the asset surplus transferred to a subsidiary by such push down can be booked in the subsidiary as reserve from capital contributions or can also be used for the tax free creation of formal capital.

Immigration into Switzerland

Switzerland allows the immigration of corporate entities. When immigrating a corporation into Switzerland the equity of such company must be qualified as formal capital, as reserve from capital contributions or as other reserve. For the qualification of the equity of the immigrating entity it will, for Swiss tax purposes, be decisive how the reserves were created when the immigrating company still was a non-Swiss company. To have certainty about the acceptance of the qualification of the reserves it is advisable to submit the qualification of the reserves (formal capital, reserves from capital contributions or other reserves) of the immigrating company to the Swiss tax administration before the immigration takes place.

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Rolf is an international tax lawyer focusing his areas of expertise on national and international tax planning, inbound and outbound transactions between the US and Switzerland, corporate restructuring and acquisitions as well as general corporate secretarial services.

burckhardt provides its clients and their businesses with comprehensive, advice on national and international tax planning issues and structuring, offers corporate secretarial and notary service, supports clients on restructurings, mergers and joint ventures, advises on inbound and outbound investments and in all matters related to employment, trade and transport law.

In the case of a cross border share to share deal (a non-Swiss company contributes shares in a (Swiss or non-Swiss) subsidiary to a Swiss company against issuance of shares by the Swiss company), then the difference between the contributed shares and the formal value of the shares issued by the Swiss company can be booked in the books of the Swiss company as reserve from capital contribution.

Reporting obligations

Contributions into the reserves of a company can only qualify as reserves from capital contributions if they are booked in a newly created balance sheet position and if every change of such position is reported to the Swiss federal tax administration. The financial statements showing a change of the account reserves from capital contributions, together with a newly created Form 170 (to be downloaded at www.estv.admin.ch), must be filed with the administration 30 days after each approval of the financial statements by the shareholder meeting. In repayment of reserves from capital contributions cases, a repayment must also be reported within 30 days by use of the same form. If in a business year no changes with respect to the position reserves from capital contributions are booked, then it is not required to file form 170.

As the principle of contributed capital has just been introduced, Swiss companies have not yet booked separate equity accounts showing the reserves from capital contributions. Capital contributions and premium payments made between December 31 1996 and December 31 2010 should still be booked as reserves from capital contributions until the end of the business year ending in 2011. Losses which were set off with such contributions can, however, not be booked as reserves from capital contributions. In order for the reserves from capital contributions to be accepted by the federal tax administration, the reserves must be reported the latest 30 days after approving the financial statements 2011 (business year equal to calendar year) or approving the financial statements 2010/2011 (business year deviating from the calendar year), as the case may be. The Swiss Code of Obligations states that companies are obliged to approve their financial statements within six months after the end of a business year. It can be expected that the final deadline for reporting contributions made between 1997 and 2010 will be July 30 2012 (for companies having a business year equal to the calendar year; for companies having a business year deviating from the calendar year, the deadline will be earlier). The federal tax administration has prepared a template that can be downloaded (http://www.estv.admin.ch) and that must be used to report the reserves from capital contributions. The prepared file must then be sent by email (kep@estv.admin.ch) to the administration. In addition it is required to file form 170 to report the reserves from capital contributions existing from January 1 2011.

For contributions made before December 31 1996 no reserves for capital contributions can be booked. Finally, the federal tax administration issued transitional rules for the repayment of reserves from capital contributions between January 1 2011 and the first regular reporting in connection with the financial statements 2011.

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