

Editorial

For many years, the share of the profits of a public limited company paid to its shareholder was considerably reduced by tax deductions, due to an unfortunate combination of corporate tax charged to the company and income tax charged to the shareholder on cashing a dividend.

This situation had a particularly unfavourable impact on the property sector, since some investors were unable, for organisational reasons, to purchase property directly (as a private individual), and were also unable to consider purchasing through a public limited company for taxation reasons. Therefore, it is extremely important, and particularly encouraging that the situation was corrected by law, putting an end, de facto, to this accumulation of tax deductions.

The changes made and described in detail below confirm that it is now almost the same, from a tax perspective, to purchase a property as an individual or through a public limited company. This cannot fail, by widening the circle of buyers and diversifying usable purchasing vehicles, to boost the Swiss property market and increase its attractiveness.



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Mitigation of economic double taxation

I. Economic double taxation

1. Concept and tax effect

Economic double taxation of the profits of a joint stock company results from the combination of taxation of the company of net profits earned (corporate tax) and taxation of shareholders when these same profits are distributed (income tax). Furthermore, these distributions are subject to withholding tax of 35 %, which can however be reimbursed under certain conditions.

The double taxation is “economic” because it does not affect the same person (the first time the company and the second time the shareholder). It is however strongly felt by “family-run” companies, whose shareholders are comprised of a limited circle of people. On the other hand, it hardly ever causes problems for companies listed on the stock exchange.

Under cantonal law, there is also economic double net worth tax. In fact, shareholdings are subject to net worth tax, whereas the value that they represent has already been taken into account, at least partly, by tax on capital at company level.

Economic double taxation clearly distinguishes between the tax status of an entrepreneurial activity developed in the form of a joint stock company and that developed in the form of a partnership. In fact, in the latter case, the net income earned is subject to income tax directly from the entrepreneur (single taxation), at a progressive rate applicable to individuals.

Having said this, in the absence of distribution, profits of joint stock companies are only subject to corporate tax. As the marginal rates of corporate tax on companies are considerably lower than those of income tax, the system leads to a withholding (hoarding) of profits within the company (“lock-in effect”).

2. Problem of fringe benefits

Due to the existence of economic double taxation of profits earned by a company, there is great temptation for shareholders to establish their relations with the company in such a way as to reduce this effect as much as possible. Typically, shareholders will try to increase tax-deductible expenses of the company (salaries, rents, indebtedness, etc.), or to reduce profits by offering

benefits at favourable prices to shareholders or their close relations (favourable interest rates, etc.). On their side, the tax authorities will check that the relations between the company and its shareholders (including their close relations) correspond to what relations with independent third parties would have been under similar conditions. In fact, if the company grants a shareholder, or a closely related person, advantages that it would not have granted third parties, this is a fringe benefit, which must be reintegrated into the company’s taxable profit.

Of course, legal documents signed between a joint stock company and its shareholders are fully valid legally. Shareholders can conclude loans, leases, sales or other service contracts with their company. However, and the Federal Court has confirmed this many times, the public limited company remains an independent person in law with a view of profit. Such an entity must therefore establish business relations with its shareholders or other close persons under the same conditions as with third parties. This rule is well known as the “arm’s length principle”.

According to the Federal Court, four cumulative conditions must be met to establish the existence of a fringe benefit : (i) the company provides a benefit without obtaining corresponding consideration ; (ii) this benefit is granted to a shareholder or to a closely related person ; (iii) it would not have been granted to a third party under such conditions ; (iv) the disproportion between the benefit and the consideration is evident, to such an extent that the company’s bodies would have been aware of the advantage they were granting.

Fringe benefits appear in the form of unjustified costs (excessive salary, payment of disproportionate interest, too high remuneration for a service, etc.), insufficient accounting of revenue (favourable interest rates granted by the company, inappropriate consideration for a company service, etc.), an excessive reduction of assets (acquisition of assets without value, etc.) or an increase in fictitious liabilities (fictitious loan, etc.).

In the event of a fringe benefit, the amount of the benefit is reintegrated into the company’s taxable net profit and constitutes a yield on participation taxable