TREASURY SHARES – CHANGE IN PRACTICE

Under today's accounting law, treasury shares are no longer recorded as an asset in the balance sheet following a buyback of own shares. In its landmark decision of 14 November 2019, the Federal Supreme Court signalled that a comprehensive systematic change in practice is also required in tax law.

1. Previous practice

Under previous law, treasury shares were recorded as an asset in the statutory balance sheet and a separate reserve was created and reported in equity. As a result, for corporate income tax purposes the authoritative principle (tax follows book) came into play, although with exceptions due to the withholding tax treatment of the share buyback.

If the buyback resulted in a withholding tax charge due to the maximum holding period or purchase limits being exceeded, treasury shares were disregarded in the tax return of the company, notwithstanding the recognition as an asset in the statutory balance sheet. Valuation differences recognized under statutory accounting law for such (so-called amortised) treasury shares were, therefore, irrelevant for corporate income tax purposes. If such amortised treasury shares were resold above nominal value, this was qualified as a tax-neutral capital contribution.

However, if the buyback did not result in a withholding tax charge, the treasury shares had to be valued periodically after the buyback, and valuation differences recognized through profit or loss were relevant for corporate income tax purposes due to the authoritative principle. Profits or losses from the sale of treasury shares also resulted in a change in taxable profit. There was no reduction in taxable equity due to the recognition as an asset and formation of a separate reserve in equity.

2. New practice

2.1. Accounting law

Under today's accounting law, treasury shares are no longer recorded as an asset. Instead, equity is reduced in the amount of the acquisition cost and a separate negative reserve must be reported in equity (Article 959a [2] [3] [e] of the Swiss Code of Obligations [Obligationenrecht, OR]). Following the initial entry of the negative reserve at cost of acquisition, there is no subsequent valuation in the statutory balance sheet according to the audit practice. There is, therefore, no longer a basis under the revised accounting law to take account of the valuation differences of treasury shares in the statutory balance sheet during the holding period.

If treasury shares are not eliminated but resold, the negative reserve must be reversed. According to audit practice, differences between the sales proceeds and the acquisition costs

are to be recognised directly in equity. However, the recognition in the profit and loss account is also accepted.

2.2. Tax law

On the one hand, tax implications of the changes in accounting law arise in the area of taxable equity. In the judgment of 14 November 2019, the Federal Supreme Court ruled that the negative reserve reduces the taxable capital. According to the Federal Supreme Court, there are no correction provisions in tax law that would justify a deviation from the statutory balance sheet.

Due to the hinge effect of the authoritative principle, the paradigm shift should, however, equally apply in the area of corporate income tax, although the Federal Supreme Court did not express an explicit opinion on this. Valuation differences of treasury shares should remain tax-neutral during the holding period, as there are no tax law provisions allowing for a deviation from the statutory balance sheet here either. The same applies to the resale of treasury shares. If sales proceeds are not recognised through profit or loss, the valuation differences should remain neutral for corporate income tax due to the authoritative principle and the lack of tax correction provisions. By contrast, if profits and losses from the sale were recognised in the income statement, these would be relevant for corporate income tax purposes, unless such treasury shares were already amortised for withholding tax purposes.

However, both the Swiss Tax Conference (SSK) and the Swiss Federal Tax Administration (FTA) seem to adhere to the current practice. Both valuation differences during the holding period as well as profits and losses from the disposal of treasury shares are regarded as relevant for tax purposes irrespective of the statutory balance sheet treatment. However, the aforementioned Federal Supreme Court decision gives reason to critically question the tax practice expressed in publications issued by the SSK and FTA with respect to corporate income tax. If necessary, the outdated practice must be corrected on a procedural level.

ADB ALTORFER DUSS & BEILSTEIN AG

+41 44 267 63 00