

# NewsLetter

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## Swiss Tax Treatment of Own Shares – Deadline for Accounting Adjustments set for 31 July 2002

**A continued holding of own shares for more than six years leads to adverse Swiss income and withholding tax consequences because it is viewed as a partial liquidation. The six-year period can be extended if own shares are used or reserved for convertible bonds, bonds with an option for conversion into shares or employee benefit plans. The Swiss Federal Tax Administration has clarified the requirements regarding the accounting treatment of such extensions. The amendment to the earlier circular letter sets a deadline to make the necessary accounting entries by 31 July 2002.**

### Corporate Law Background

According to Swiss corporate law, the direct or indirect holding of own shares is restricted to 10 % of the total share capital issued by the company. The limit is



by Martin Busenhart  
+41 1 265 75 80  
mbusenhart@wwp.ch

increased to 20 % if registered shares are repurchased in connection with transfer restrictions. In the latter case, share holdings in excess of 10 % have to be re-sold within two years.

In any case, the repurchase of shares requires retained earnings

or other freely distributable reserves to be at least equal to the amount of the purchase price. In this amount, retained earnings or other freely distributable reserves are converted into a special reserve that has to be accounted for and reflected separately in the balance sheet.

### Swiss Tax Consequences

From a Swiss tax point of view, the repurchase of own shares for the purpose of a capital redemption or in excess of the 10 or 20 % limits provided by corporate law leads to a so-called partial liquidation. Based on tax law referred to in the earlier circular letter issued by the Federal Tax Administration on 19 August 1999,

the partial liquidation rules also apply if own shares (according to the first-in first-out principle: "FIFO") are continuously held for a period of more than six years, unless specific extensions apply.

Under the partial liquidation rules, the share transfer is not treated as a purchase but as a distribution. Accordingly, Swiss withholding tax of 35 % is due on the difference between the repurchase price and the paid-in nominal share amount at the time of the repurchase. A partial or full refund of the Swiss withholding tax is only granted if certain conditions are met. For Swiss individuals having held the repurchased shares as a private (non-business) asset, the amount subject to Swiss withholding tax is treated as taxable income for income tax purposes.

### Clarification Regarding Extension

In specific situations, the six-year period can be extended as was mentioned before. The six-year period does not start or is extended if and when own shares are reserved for convertible bonds, bonds with an option for conversion into shares or employee benefit plans, which are in place or planned. In the case of convertible bonds and bonds with an option for conversion into shares, the six-year period is extended during the term of the bond whereas in the case of employee benefit plans, the extension period is limited to a maximum of six years.

According to the Federal Tax Administration's clarification dated 26 March 2002, a reservation of own shares for bonds or employee benefit plans, planned or in place, must be clearly reflected in the statutory accounts. Besides the general account for own shares, the Federal Tax Administration requests (1) a separate account for each project in place and (2) an additional account for planned projects. Only own shares included in the account for planned projects can be shifted to a specific account upon the issuance of a bond or employee benefit plan. Accordingly, in the

account for planned projects, own shares should be allotted to and earmarked for the planned transactions they are reserved for. Otherwise, the allocation to a future project may be barred. After 31 July 2002, a shift from the general account to the account for planned projects may not extend beyond the six-year period in case of a future issue. The account for planned projects as well as the accounts for single projects should only have transactions in connection with such projects (e.g. delta hedging).

### Addressees of the Clarification

Addressees of the clarification and the respective deadline are all Swiss listed and privately owned companies other than banks, which have own shares reserved for future projects or have shares reserved for already existing projects. The holding of own shares can be either a direct one by the company itself or an indirect one through a Swiss or foreign subsidiary (or a number of subsidiaries and sub-subsidiaries).

Swiss companies holding shares of their Swiss parent companies should comply with the rules whereas Swiss companies holding shares of their foreign parent companies are not subject to the rules of Swiss corporate law on own shares and, accordingly, are not impacted by the deadline.

### Conclusion

It seems to be the intention of the Federal Tax Administration to strictly apply the accounting requirements as well as the deadline for adapting accounting practice to such requirements.

As with every circular letter issued by the Federal Tax Administration, the clarification statement could be contested in administrative and court procedures. There is some doubt whether the extension provided by law can have conditions and restrictions applied to it by a circular letter of the Federal Tax Administration. However, as one cannot exclude the possibility that a court will uphold the guidelines issued by the Swiss Federal Tax Administration in its circular letter, compliance becomes a major issue.

In any case, it is highly recommended to reassess the situation with regard to own shares. A proper monitoring and controlling was and is of crucial importance to avoid unforeseen and adverse legal and tax consequences for both the company and its shareholders. In order to guarantee strict adherence to the guidelines provided in the circular letter in its amended

form, it is strongly advisable to react promptly and to split the account for own shares into a general account, an account for future projects and separate accounts for each convertible bond, each bond with an option for conversion into shares and each employee benefit plan issued before 31 July 2002.

The new rules may also offer a one-time planning opportunity. Own shares, which up to now were entered in the general account for own shares and are not clearly enough dedicated to a current or future project, can be shifted from the general account to separate accounts for projects in place or to the account for planned projects.

Keeping the statutory accounting in line with the guidelines issued in the circular letter enables companies to take full advantage of the extension rules and eliminates the risk of taxation liabilities based on the theory of "partial liquidation".

### NewsLetter

The ww&p NewsLetter provides comments on new developments and significant issues of Swiss law. These comments are not intended to provide legal advice. Before taking action or relying on the comments and the information given, addressees of this NewsLetter should seek specific advice on the matters which concern them.

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**Walder Wyss & Partners**  
**Attorneys at Law**

Münstergasse 2  
P.O. Box 2990  
CH-8022 Zurich  
Phone +41 1 265 75 11  
Fax +41 1 265 75 50  
reception@wwp.ch  
www.wwp.ch

London Office  
9 Gray's Inn Square  
London WC1R 5JQ  
Phone +41 20 7405 2043  
Fax +41 20 7405 0605