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Tax loss allocation in real estate companies – clarification by the Federal Supreme Court

If a real estate company, which is taxable in several cantons, incurs losses in one or more cantons, the question arises as to whether these losses must be borne primarily by the primary tax domicile or proportionately by all profitable secondary tax domiciles.

1. Facts

A real estate company with registered seat and primary tax domicile in the canton of Aargau and secondary tax domiciles in various cantons achieved a total profit of around CHF 9.5m in the fiscal year 2013. At its primary tax domicile Aargau and its secondary tax domicile in Thurgau, as well as in four other cantons, a total profit of around CHF 11m was generated, while in three cantons (all of them so called "special tax domiciles") a total loss of CHF 1.5m was incurred.

When assessing the fiscal year 2013, the cantonal tax administration of Aargau apportioned the loss of CHF 1.5m to all domiciles in cantons with positive results.

The cantonal tax administration of Thurgau, on the other hand, rejected the offset of a proportional part of the losses against

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the profit incurred in its own jurisdiction and took the view that the canton of Aargau had to assume the losses in full since the real estate company's primary tax domicile was in that canton. This decision was confirmed by the cantonal administrative court in Thurgau.

Upon appeal by the real estate company, the Federal Supreme Court had to rule whether the canton of Thurgau as the company's secondary tax domicile had to bear a proportional part (that is, in accordance with the positive results of the cantons) of the loss incurred in other cantons or whether this loss was to be borne by the primary tax domicile in Aargau in full.

2. Decision by the Federal Supreme Court

In its decision 2C_285/2018 of 5 November 2019, the Federal Supreme Court found that the cantonal practices regarding the application of Circular Letter No. 27 by the Swiss Tax Conference dated 15 March 2007 on real estate companies were inconsistent. The court held that neither the practice applied by the Thurgau tax authorities nor the one upheld by the Aargau tax authorities violated the prohibition of inter-cantonal double taxation per se. Where, however, as in the present case, different loss allocation methods were applied jointly, situations could arise where (part of) the losses incurred in one canton would not be offset against profits in other cantons which would finally result in a breach of the prohibition of inter-cantonal double taxation.

According to the Federal Supreme Court, the practice of the Thurgau tax authorities (taking over of losses primarily by the primary tax domicile) was more aligned with the fundamental principle according to which real estate profits are to be taxed at the location where the respective property is situated. A mix of methods (objective determination of profits on the one hand, proportionate allocation of losses on the other hand) should be avoided as far as possible. In the case of the "Thurgau practice", such

a mix of methods could only arise if the profit reported at the primary tax domicile was lower than the cumulative losses of the individual cantons. According to the Federal Supreme Court, this practice should therefore be given priority.

The Federal Supreme Court concluded that losses incurred by real estate companies primarily had to be offset against profits at the primary tax domicile; only if the total losses exceeded the profit at the primary tax domicile, the exceeding part of the loss had to be borne proportionally by the secondary tax domiciles.

3. Conclusion and recommendation

The Federal Supreme Court has ruled that the practice applied by some cantons, according to which losses incurred in secondary tax domiciles need to be borne proportionally by all secondary tax domiciles ("Aargauer practice"), must not be applied if this leads to unintended inter-cantonal double taxation.

Instead, it is the primary tax domicile which has to bear the losses primarily ("Thurgauer practice").

In order to calculate the expected corporate taxes it is essential for a real estate company to know how the taxable profit will be split up among the cantons.



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