


# The abolishment of holding company status: Measures to mitigate tax burden

The Federal Act on Tax Reform and AHV Financing (TRAF) abolished cantonal tax privileges for holding, domicile and mixed companies. **Roland Böhi** and **Lukas Scherer** of **Prager Dreifuss** analyse the impact of the reform and assess the transitional measures set up to alleviate an additional tax burden.



**O**n January 1 2020, the corporate tax reform entered into force. The Swiss cantons have some margin of discretion in the implementation of the legislation. Differing cantonal peculiarities and characteristics are, hence, to be expected.

With the enactment of the corporate tax reform, the cantonal tax privileges for holding, domicile and mixed companies were abolished. To mitigate the additional tax burden, companies that benefitted from privileged tax treatment until the end of 2019 have the option of disclosing their hidden reserves tax-neutrally and depreciating them over a period of 5-10 years ('old step-up'). Alternatively, the affected companies can apply for an order by the competent tax administration to determine the amount of hidden reserves. These hidden reserves can then be taxed at a special tax rate over a period of 5 years in case of realisation ('special rate solution'). These two measures are both to be implemented at cantonal level. The treatment of hidden reserves is regulated by the cantonal law to some extent. Other questions, however, remain unanswered, in particular, the handling of value recoveries on depreciated participations and the treatment of non-adjustable values on assets and liabilities after change of tax status. In this article, issues are identified, and their consequences and potential solutions are discussed.

## Old step-up

### General

If, in the context of a change of tax status, the previously privileged taxed company (holding, domicile or mixed company) chooses the option of applying the old step-up, it can disclose its hidden reserves accumulated during the privileged tax status as well as the created goodwill tax-neutrally in its tax balance sheet. The disclosed hidden reserves can then be depreciated over a specific period of time (5-10 years, varying from



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canton to canton). Depending on the canton, either a dynamic or a linear depreciation may be chosen. These depreciations are subject to cantonal tax relief restrictions. The cantons designed – to a certain extent – the regulations according to their own needs and interests. Therefore, the regulations vary greatly from canton to canton (while e.g. the canton of Zug provides for an overall tax relief restriction of 70%, the canton of Basel-Stadt applies an overall tax relief restriction of 40%).

For companies that benefitted from the holding tax status, the old step-up situation is different with respect to participations, portfolio shares and non-adjustable values on assets and liabilities after change of tax status.

### Participations

In case of qualified participations (i.e. at least a 10% stake, rights to at least 10% of the profits and reserves, or at least a participation with a market value of 1 million Swiss Francs), the difference in value between the market value and the tax investment costs will remain tax-exempt because of the participation relief granted even after the change of tax status.

Therefore, disclosure of these hidden reserves in a tax-neutral manner is not necessary. However, recovered depreciations (i.e. the difference between the tax investment costs and the lower tax book value) will generally be subject to ordinary taxation regardless of the fact that they would have not triggered any tax consequences at cantonal level under the prior holding status. In order to avoid that a later recovery in value would lead to ordinary taxation of the recovered depreciations, the investment costs or the tax book value of the participations concerned have to be adjusted. If the market value is higher than the investment costs, an increase in the tax book value up to the investment costs is justified. If, on the other hand, the market value is lower than the investment costs, the tax book value should be increased to the market value. In this case, the investment costs should also be adjusted to the lower market value for purposes of cantonal corporate income tax. This approach ultimately leads to different tax book values and investment costs of the concerned participations for purposes of the direct federal tax and the cantonal tax. Another point is that the cantonal tax consequences of future value increases up to the acquisition value of the investment.

In the past, value adjustments on participations were not subject to profit taxation at cantonal level. The same applies if the value adjustment on participations occurs in the context of the change of tax status. However, at federal level value adjustments were always subject to tax (except if offsettable against tax losses). Consequently, value adjustments on participations would result in profit tax implications. One solution would be to merely adjust values of participations for tax purposes at cantonal level. The downside is a different tax base for the same assets at federal and cantonal level. Another solution could be to adjust the value of participations in the 2019 stand-alone financial statement, if possible up to the historical investment costs before the change of status. The downside of such value adjustments are federal profit tax implications. The upside are no tax implications at cantonal level, since the company still benefits from the cantonal holding tax status, corresponding tax bases at federal and cantonal level and mitigation of the future deferred tax liability.

Only a few cantons have explicitly opined on the possibility of adjusting tax book values and investment costs. In order to obtain clarity on the future tax treatment of recovered depreciations after change from the holding status to ordinary taxation, it is highly recommended to contact the competent cantonal tax administrations as quickly as possible – in most cantons the latest before filing the tax return for the financial year 2019 – and, if possible, to request a tax ruling confirming the future handling for corporate income tax in this area.

### Portfolio shares

From a tax perspective portfolio shares are shares with a participation rate lower than 10%. Holding companies

receiving income on portfolio shares with a market value of at least 1 million Swiss Francs or which grant rights of at least 10% of the profits and reserves benefit from the participation relief. Such qualification was only relevant at federal level but irrelevant at cantonal level since no profit was taxed under the holding tax status. After the change of tax status, dividends resulting from portfolio shares that meet these requirements will still benefit from the participation relief; at federal as well as at cantonal level. The cantons have not explicitly opined on adjusting tax book values of portfolio shares. Systematically, however, no value adjustments should be possible on portfolio shares that benefitted from the participation relief before (and after) the change of tax status.

Under the holding regime income on portfolio shares that did not qualify for the participation relief only triggered tax implications at federal level. At cantonal level such income was not taxed due to the holding tax status. Consequently in the future, a company should be able to disclose its hidden reserves on portfolio shares accumulated during the privileged tax status in a tax-neutral manner in its tax balance sheet. The disclosed hidden reserves can then be depreciated – in a linear or dynamic way – over a specific time-period (5-10 years, varying from canton to canton). Do note though that the deferred tax liability caused by the change of tax status may not be exhausted by this measure.

#### Future tax treatment in case of non-adjustability of values on assets and liabilities after change of tax status

Swiss accounting standards based on the Swiss Code of Obligation and Swiss GAAP allow for the creation of hidden reserves on assets and liabilities. This also includes provisions.

As a general rule, the re-capture of values on assets and liabilities needs to be formed in line with the principle of prudence (Vorsichtsprinzip) set out in the Swiss Code of Obligation. Value adjustments are generally possible up to the investment costs. Such value adjustments are, however, not possible if the value cannot be determined clearly and are therefore – in line with the principle of prudence – unlawful from an accounting (and tax) perspective. In such situations, the book values of the affected assets and liabilities correspond to the true value and no hidden reserves are available at the moment of change of tax status. Therefore, no hidden reserves can be disclosed and the old step-up regime is not applicable.

Before the change of tax status, the re-capture of values only triggered profit tax consequences at federal level (no profit was taxed under the holding tax status at cantonal level). Due to non-availability of hidden reserves at the moment of change of tax status, future value adjustments will occur under ordinary taxation. The re-capture in value in the future would consequently trigger profit tax at federal and cantonal level.



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Systematically, hidden reserves on assets and liabilities created under the holding tax status should not be subject to profit taxation on cantonal level after the change of tax status. The cantons have, however, not disclosed how they intend to handle the future re-capture of values on assets and liabilities other than participations after the change of tax status, if the old step-up is not applicable at the moment of change of tax status. It is therefore highly recommended to discuss and rule the possibilities of special tax treatments of future value adjustments on such assets and liabilities with the competent cantonal tax administrations. One solution might be the non-taxation of future re-capture of values during the same time period as applied for depreciations under the old step-up regime (i.e. 5-10 years).

#### Timeline

With a few exceptions, most cantons re-quire the disclosure of hidden reserves up to and including the last tax period of privileged taxation (in principle with the tax return for the business year 2019). Some cantons provide for the possibility of disclosing the hidden reserves in the according tax period and others recommend to file a ruling beforehand for

further clarification of the concrete handling of the hidden reserves. We will gladly help you to find the right approach for the specific fact pattern.

### Special rate solution

As an alternative to the old step-up, it is possible to have the hidden reserves determined by means of an order by the competent tax administrations. These hidden reserves are then subject to reduced taxation during the following five years at the time of their realisation. If the hidden reserves are only realised after the five-year period, they are subject to the higher ordinary tax rate.

What applies to the old step-up also applies to the special rate solution: The special rate is only applicable if the income was not taxable under the old law. Therefore, it is not possible to apply it to qualified participations or portfolio participations that benefit from the participation relief.

In contrast to the old step-up, the taxation of hidden reserves by means of the special rate solution is not subject to the cantonal tax relief restrictions. Compared to the old step-up this measure should impact less on the tax note under IFRS or US GAAP. Regarding the treatment of the

recovered depreciations on participations and non-adjustable values on assets and liabilities at the moment of change of tax status, an analogous application of the rules on the old step-up seems justified.

### Conclusion

Which of the two mechanisms, old step-up or special rate solution, is more advantageous depends highly on each individual case and on the specific assets or liabilities in question (e.g. with regard to the handling before and after the change of status for tax purposes). The step-up allows for a depreciation of the disclosed hidden reserves during a period of up to 5-10 years, depending on the canton. However, cantonal relief restrictions need to be taken into account. The special rate solution has no relief restriction, but is limited in any case to 5 years. Some cantons even provide for a combination between the step-up and the special rate solution, as for example the canton of Zurich.

For both measures it is highly recommended to file a tax ruling with the competent cantonal tax administrations with regard to the concrete handling of the hidden reserves on the different assets and liabilities.

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