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BÄR & KARRER BRIEFING SEPTEMBER 2024

WEALTH TAX RELIEF FOR ENTREPRENEURS USING THEIR COMPANIES AS "WORK TOOLS"

With the recent rejection of the bill aimed at easing the wealth tax burden for individual shareholders using their shares as a "work tool" in the Canton of Geneva, this briefing takes the opportunity to explore alternative solutions adopted by other French-speaking Swiss cantons. We provide insights into how various regions address the issue of wealth tax valuation, highlighting measures that offer tax relief for shareholders in mostly small to mid-sized and family-owned businesses. This overview covers regulations in the cantons of Vaud, Valais, Fribourg, Neuchâtel, Jura, and Bern.

PROBLEM AT HAND

When a business is operated as a sole proprietorship or partnership, profits are taxed directly as personal income, and the business's net assets are subject to wealth tax. In contrast, when a business is run through a company (SA/Sàrl), it faces double taxation: the company pays corporate income tax on its net profits and capital tax on its net equity, while individual shareholders pay income tax on dividends and wealth tax on the value of the shares in the company. For wealth tax purposes, the value of unlisted shares is assessed using a method proposed by the Swiss Tax Conference ("CSI"), which consists of calculating an average of the company's net equity (single weighting) and capitalised net profit of the last two or three business years (double weighting). For the purposes of this publication, we will refer to this method as the "CSI Method".

Since the CSI Method is partly based on capitalised profits, it often results in a value that is higher than the company's equity, leading to a higher wealth tax burden than would be the case if the business were run in a non-corporate structure, such as a sole proprietorship or partnership. This is particularly the case for small to mid-sized companies as well as family-owned companies, whose activities could also be conducted through a partnership or a sole proprietorship (such as professional services). The owners of these businesses often opt for a corporate structure primarily to protect themselves from personal liabilities.

To address this concern, several cantons are developing or have already implemented special wealth tax calculations for business owners using companies as their "work tool" (*outil de travail*), an overview of which we provide below for the French-speaking Swiss cantons.

VAUD

In the Canton of Vaud, the valuation of unlisted shares for wealth tax purposes follows the CSI Method. With the recent introduction of the RETIF (*Regulation on the Valuation of Unlisted and Irregularly Traded Shares for Wealth Tax*), shares may now be classified either as "work tools" or as shares of a company whose value depends solely on its shareholders in a "one-man show" scenario.

Shares may be classified as "work tool" if the shareholder holds at least 10% of the company's capital, has control over the company, alone or through a shareholders' agreement, and is actively involved in the company in a managerial role with appropriate compensation. Shares that are listed or are held within an individual's business assets, or shares of cooperatives, wealth management firms or dormant companies may not be classified as "work tool". The relief offered under the "work tool" designation allows for an increase in the standard capitalisation rate applied to the historical net profits of regular companies, ranging between 7.0% and 9.5% over the past five years, to a rate of 16%, which reduces the resulting earnings value. Often, the classification as "work tool" allows the wealth tax value to be reduced by 30-40%.

In a "one-man show" scenario, where a company's success hinges largely on a particular individual or a small group, the valuation will reflect the equity value if specific conditions are met. These include owning at least 10% of the shares and ensuring that each shareholder is actively employed by the company. If there are multiple shareholders, a shareholders' agreement must be in place that establishes the buyback price of the shares at the equity value, and this agreement must be submitted to the tax authority. Additionally, the company's net income must not exceed 10% of the justified commercial expenses, excluding compensation for shareholders.

These two special valuation methods are applied only upon request by completing a designated form, and are not automatically considered by tax authorities.

VALAIS

The Canton of Valais has introduced legal provisions and administrative guidelines that are similar to the tax relief seen in the Canton of Vaud. Consequently, unlisted shares may be valued lower for wealth tax purposes if they function as a work tool or if they belong to a company whose value primarily depends on its shareholders (the "one-man show" scenario).

Under the new legal provisions, if a taxpayer holds at least 10% of a qualifying interest, the determining value (with or without adjustment for earning potential and with or without minority participation) is set at 60% of the usual valuation according to the CSI Method.

In cases where a company's value is largely driven by a majority shareholder (the "one-man show" scenario), the tax authority may modify the CSI Method by reducing the value of the company's historical net profits by a percentage based on the gross salary of the majority shareholder in relation to the company's total payroll, while ensuring that the value does not fall below the company's equity value. This determined value applies to all shares, including those held by minority shareholders, who can choose to forgo this reduction if noted in their tax return.

FRIBOURG

For individual taxpayers in Fribourg, there is a tax relief that reduces the average wealth tax rate by 40% on private wealth associated with shares in Swiss companies that are not listed or regularly traded. Taxpayers can request this relief in writing.

For companies largely dependent on a single individual, if certain conditions are met—such as the individual holding at least 50% of shares and receiving at least 75% of total gross salaries, which must be adequately documented—there can be a proportional reduction in the value of the company's historical net profits, similar to the approach used in Valais. If this results in a valuation below the equity value, the equity value is used as the minimum. This valuation applies to all shares in the company, and no other deductions are allowed.

NEUCHÂTEL

Shareholders residing in the Canton of Neuchâtel who own shares in Swiss companies can benefit from a 60% reduction on the taxable value of these shares for wealth tax purposes. Such a reduction is applied regardless of whether the shareholder actively works in the company and is independent from any minimum ownership percentage in the company. The wealth tax rate is calculated based on the taxable value before this reduction is applied.

JURA

Shareholders residing in Jura who hold shares in Swiss companies that are neither listed nor traded on organised markets benefit from a valuation reduction. These shares are assessed at their market value using the CSI Method, with a reduction of 30% applied to the difference between this value and the shares' nominal value. Such a reduction is applied regardless of whether the shareholder actively works in the company and is independent from any minimum ownership percentage in the company.

BERN

The Canton of Bern has not implemented any special measures regarding wealth tax on shares of companies that function as a “work tool”. As a result, the valuation of all unlisted shares is conducted using conventional methods, including the CSI Method. Although in practice, the Bern tax authority may consider foreseeable events affecting the valuation of shares to grant a reduction of the wealth tax value, there is no readily available instrument in the Canton of Bern that would allow for a mitigation of the economic double taxation on the shares of companies used as a "work tool".

GENEVA

On September 22, 2024, the Canton of Geneva voted on a bill designed to lower the wealth tax burden for privately held companies used as a "work tool" by up to 80%. The bill was rejected in the popular vote. Due to the rejection, the Canton of Geneva fails to increase its fiscal attractiveness for entrepreneurs organising their business in the form of a corporate entity.

The contents of this publication are for reference purposes only and reflect the situation as of September 2024. They do not constitute legal advice and should not be relied upon as such. Specific legal advice about your specific circumstances should always be sought separately before taking any action based on this publication.

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