

BRIEFING JULY 2021

NOTIONAL INTEREST DEDUCTION FOR COMPANIES IN THE CANTON OF ZURICH

From 1 January 2020, companies domiciled in the Canton of Zurich have been able to claim a notional interest deduction for cantonal and communal profit tax purposes. An imputed (notional) interest deduction on a certain portion of the company's equity (security equity) may be deducted from its taxable profits. As the calculatory interest rate published by the SFTA currently amounts to 0%, this potential deduction is limited to the portion of the security equity attributable to all types of receivables from group companies (for which a third-party interest rate may be applied). Taking into account the applicable maximum discharge threshold, a reduction of up to 46% in the effective tax burden (around 9% points) may be achieved for the City of Zurich.

BACKGROUND

With the entry into force of the Federal Act on Tax Reform and AHV-Financing (TRAF) on 1 January 2020, the instrument of notional interest deduction became an integral part of Swiss tax law and was made available to the cantons for voluntary implementation. Until now, only the Canton of Zurich has chosen to implement this option for cantonal and communal profit taxes purposes.

WHO SHOULD THINK ABOUT OPTING FOR THE INSTRUMENT?

From a tax point of view, the equity deduction is attractive particularly for highly equity capitalised companies, such as group financing companies with cash pooling or treasury functions, and possibly also for financial institutions and holding companies. It may also be worth considering building up a new group company with functions as described above.

ILLUSTRATIVE EXAMPLE

A company with its registered office in Zurich has assets and liabilities as follows. In addition, the company generates taxable profit before interest charges of CHF 7 million in the financial year 2021.

ASSETS		LIABILITIES	
Cash	20 m	Liabilities	50 m
Other Receivables	30 m		
Loans to Related Parties	100 m	Shareholder's Equity	100 m
Total Assets	150 m	Total Liabilities	150 m

CALCULATION OF THE SECURITY EQUITY AND THE NOTIAL INTEREST DEDUCTION

BALANCE SHEET ITEM	INCOME TAX VALUE (AVERAGE)	APPLICABLE MULTIPLIER	CORE EQUITY	SECURITY EQUITY AND LIABILITY	PRO RATA SECURITY EQUITY
Operating Liquid Assets	20 m	0 %	0	20 m	16.3 %
Other Receivables	30 m	40 %	12 m	18 m	14.6 %
Loans to Related Parties	100 m	15 %	15 m	85 m	69.1 %
Total	150 m		27 m	123 m	100.0 %

CALCULATION OF SECURITY EQUITY

Total Shareholders' Equity	100.0 m
Less Core Equity	27.0 m
Total Security Equity	73.0 m
Security Equity attributable to Loans to Related Parties (69.1%)	50.4 m
Calculatory Interest (2%)	1.0 m

Assuming that based on the above calculation an amount of CHF 1 million can be claimed as a notional interest deduction from the taxable profit, the taxable profit subsequently decreases from CHF 7 million to CHF 6 million at the cantonal and communal level, resulting in tax savings of about CHF 130,000 per tax year.

CONCLUSION

The notional interest deduction is an attractive tax planning tool for highly equity capitalised companies domiciled in the Canton of Zurich and granting intercompany loans.

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