Accounting and reporting in a foreign currency – what are the Swiss tax implications of a foreign functional currency?

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Key takeaways

- **A company with its registered office in Switzerland may keep its accounts either in Swiss francs or in the currency that is required for business operations (functional currency).**
- **With the introduction of the Revised Swiss Company Law as of 1 January 2023, it will now also be possible for companies with a corresponding functional currency to set the share capital in EUR, USD, GBP or JPY.**
- **For Swiss corporate income tax and capital tax purposes, the profit/loss according to the statutory stand-alone financial statements prepared in functional currency is generally decisive. This also applies in particular to the determination of tax relief on income and capital gains from participations (participation relief) as well as for the consideration of prior-year losses.**
- **Swiss Tax assessments and tax payments are made in Swiss francs. From 2023 onwards, binding conversion rates will be applied for conversion from the functional currency. In contrast to previous practice, the link to historical exchange rates is to be abandoned.**
- **Depending on exchange rate differences, the choice of functional currency can have a significant impact on the tax burden in Switzerland.**

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Can Swiss companies have a foreign functional currency?

Companies that have their registered office in Switzerland and are therefore subject to Swiss accounting and financial reporting law must keep their books either in Swiss francs or in the currency that is required for business operations. Companies operating in an international environment therefore have the option to keep their accounts in the foreign currency that is most relevant for their business (functional currency) instead of in Swiss francs. If a foreign functional currency is chosen, the company must prepare financial statements converted into Swiss francs in addition to the financial statements in the respective functional currency. Often the figures in functional currency and in Swiss francs (presentation currency) are presented side by side in the same document.

How does the choice of a foreign functional currency impact the profit taxable in Switzerland?

For Swiss corporate income tax and capital tax purposes, the statutory stand-alone annual financial statements are generally the basis for the tax assessment. According to case law, the profit/loss in functional currency is decisive. Tax assessments and tax payments, on the other hand, are always made in Swiss francs. In principle, the annual financial statements converted into Swiss francs are used as a basis. An annual average rate is generally used for the income statement, historical rates for equity items and in some cases for financial assets, and closing rates for other balance sheet items. On 1 January 2023, most of the provisions of the Revised Company Law will come into force. The resulting changes in tax law now make it clear that the functional currency is decisive for tax purposes. In addition, it is now stated that the taxable profit in Swiss francs is to be determined at the average (selling) exchange rate of the relevant financial year and the taxable capital in Swiss francs at the (selling) exchange rate prevailing on the balance sheet date. As a result, balance sheet items translated at historical rates in the annual financial statements presented in Swiss francs become irrelevant. While there was previously a certain degree of discretion in the exchange rates used, the exchange rates published by the Federal Tax Administration will now be binding.

How should exchange rate differences be treated?

If a company carries out a transaction in a currency other than its functional currency and makes a gain or incurs a loss on translation into its functional currency, this is referred to as a transaction difference. Transaction differences – including those between the Swiss franc and functional currency – are recognised in the income statement for Swiss corporate income tax purposes. If, on the other hand, an exchange rate difference arises from the translation of an item from the functional currency into the presentation currency, the Swiss franc, it is a translation difference. Translation differences do not affect corporate income tax, regardless of how they are accounted for. If the annual financial statements in the presentation currency Swiss francs are used to determine the taxable income, any translation differences recognised in profit or loss must be adjusted along with any provisions for translation differences.

How should capital contributions in foreign currency be treated?

Until now, corporations established under Swiss law have been required to define their registered share capital in Swiss francs, irrespective of their functional currency. Therefore, when funds are contributed for paying up nominal value, they are always converted into Swiss francs. Because the amount of the nominal value remains fixed in Swiss francs, the historical exchange rate at the time of the contribution must also always be used when reconciling the financial statements from the functional currency to the presentation currency. The amount of share capital that can be repaid tax-free in the context of capital reductions is thus determined by the original value in Swiss francs.

Until now, this treatment has also been applied to what are known as 'capital contribution reserves'. These are reserves that originate from share premiums and other contributions of direct equity holders and can, for this reason, in principle be distributed again tax-free (both in functional currency and in presentation currency, taking account of the capital protection regulations). Consequently, the Swiss Federal Tax Administration has until now always accepted and confirmed capital contribution reserves only in Swiss francs (with the exception of companies that have their civil-law domicile abroad but are deemed to be resident in Switzerland for tax purposes). For the determination of the reserves that can be returned tax-free to equity holders, the values converted into Swiss francs at historical rates have therefore been decisive up to now.

The Revised Swiss Company Law will allow corporations domiciled in Switzerland to set their share capital in selected foreign currencies as of 1 January 2023, provided that the respective currency is required for the company's business operations and the accounting and reporting is done in the same currency. This will initially be possible for the currencies US dollar, euro, British pound and Japanese yen. If a company defines its share capital in its foreign functional currency, the conversion into Swiss francs will in future be carried out at closing rates.

As a result, the functional currency will be decisive for the value of capital that can be repaid tax-free. This adjustment will also affect the capital contribution reserves; the capital contribution reserves of corporations with share capital in foreign currency will now be defined in this currency and confirmed by the Swiss Federal Tax Administration.

Capital contributions (share capital and all other contributions by direct shareholders) are in principle subject to Swiss issuance stamp tax of 1%. The issuance stamp tax is determined in Swiss francs at the time the tax claim arises or falls due.

Which currency is decisive for profit distributions?

To the extent that a corporation or cooperative subject to taxation in Switzerland makes a distribution that is not a repayment of share capital or capital contribution reserves, Swiss dividend withholding tax is incurred. Subject to relief under internal law or double taxation agreements, the Swiss dividend withholding tax is 35%.

Distributions may be defined and made in Swiss francs or in any other currency. Capital protection must be guaranteed at the time of the distribution both in the currency of the share capital (mandatorily Swiss francs until the end of 2022) and in the functional currency. If the

distribution amount is determined in Swiss francs, this amount forms the assessment basis for the Swiss dividend withholding tax. Insofar, the currency of the actual payment then remains irrelevant. If, on the other hand, the distribution amount is determined in the foreign functional currency, this must be converted for the declaration and payment of dividend withholding tax. Often, general meeting resolutions already define the amounts in both currencies or the exchange rates. The exchange rates used by the taxpayers themselves are generally accepted.

What special features should be taken into account in the case of income from participations and capital gains (participation relief)?

Corporations and cooperatives subject to taxation in Switzerland may claim participation relief for income and capital gains from qualifying participations. As a rule, the participation relief results fully, or almost, fully in indirect relief on corporate income tax. For dividends, the participation relief can generally be claimed when the participation is at least 10% or a market value of at least CHF 1 million. For capital gains, a minimum participation of 10% is always required (unless this threshold is not reached due to earlier sale in parts) plus a minimum holding period of one year.

The participation relief consists of a percentage that is multiplied by the total taxable net income (before offsetting against prior-year losses) and thus reduces the tax amount. The applicable percentage results from the ratio of the net participation income to the total net profit. The net participation income corresponds to the gross income from the qualifying participations less the related expenses, consisting of financing expenses, administrative expenses (5% of the gross income without proof of lower costs), non-refundable withholding taxes and depreciation. Financing costs are generally allocated proportionally to the ratio of the capitalised value of qualifying participations to the entire balance sheet total. This option is also available for administrative expenses.

While the taxable profit is determined in Swiss francs and therefore only the amounts converted into Swiss francs (without affecting profit) must be declared in the tax return, the participation relief is determined in the functional currency. All factors relevant for its calculation must therefore be determined and declared in the tax return in the functional currency (e.g. relevant corporate income tax values and investment costs).

How should loss carryforwards in foreign currency be treated?

For Swiss corporate income tax purposes, prior-year losses can generally be carried forward for the following seven years. In principle, a binding decision on the existence of offsettable losses from the previous year is only made when these are actually offset against taxable profit. Although the loss carryforwards that can be carried forward are generally listed in Swiss francs in the tax return, the tax-relevant prior-year losses are to be determined in the functional currency (foreign currency) according to prevailing practice. Accordingly, losses carried forward in foreign currency are offset against the taxable profit in foreign currency. Only the net profit after offsetting losses is converted into Swiss francs at the average exchange rate of the current business year to determine the taxable profit.

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No legal or tax advice

This legal update provides a high-level overview of the legal situation in Switzerland and does not claim to be comprehensive. It does not represent legal or tax advice. If you have any questions relating to this Legal Update or would like to have advice concerning your particular circumstances, please get in touch with your contact at Pestalozzi Attorneys at Law Ltd. or one of the contact persons mentioned in this Legal Update.

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