

Supreme Court: Debt Waiver Constitutes Hidden Profit Distribution

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In a recently published decision of 16 February 2023 (A-1954/2022), the Swiss Federal Supreme Court decided on a case concerning the tax treatment of a debt waiver between related companies. The Supreme Court ruled in favour of the tax authorities and found that the debt waiver constituted a hidden profit distribution.

The case concerned a stock company (A) that rented office space and subsequently sublet the office to another stock company (F). F provided services of all kinds, especially within project development. The owner of the office space was not prepared to conclude a rental agreement with F because the latter had not provided the required securities.

Therefore, A signed a rental agreement and agreed to sublet the space to F. However, F did not pay any rent to A because of financial difficulties. During the relevant years, an individual taxpayer (B) was the sole shareholder of A and held more than 50% of the shares in F. The tax authorities assessed A and requested the payment of CHF 130,163.30 of withholding tax as the waiver of the rental payments constituted a monetary benefit subject to withholding tax at a rate of 35%. A appealed against the decision.

The Supreme Court ruled in favour of the tax authorities and found that the debt waiver constituted a hidden profit distribution based on the ownership relationships between A, F and B. The Court noted that hidden profit distributions are subject to withholding tax of 35% as regular profit distributions. The Court held that the waiver of the rental debts granted by A to F constituted a benefit for F and deprived A of income. The ultimate beneficiary of the debt waiver is B controlling both companies. The debt waiver was only granted because of the close relationship between A and F (both are under the control of B). A would not have given such a debt waiver to an unrelated third party. The Court further noted that a hidden profit distribution required that the unusual character of the benefit, particularly the disproportion between the benefit granted and the consideration received, must have been recognizable to the acting corporate bodies. The Court found that it is obvious that the companies involved must have recognized this disproportion as A showed irrational commercial behaviour as a prudent businessperson would not have continued the sublet agreement without consideration. It would not have been acceptable for an unrelated third party not to receive rent for years.

