

NewsLetter No.83 March 2009

Revised Swiss Guideline under the Wealth Tax for the Valuation of Securities without Market Prices



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The Swiss Tax Conference (*Schweizerische Steuerkonferenz [SSK]*) published Circular Letter No. 28 in August 2008, on the basis of which the Guideline under the Wealth Tax for the Valuation of Securities without Securities Exchange Market Prices has been revised. The old guideline was issued in 1995. While it was modified only slightly in 2006, the 2008 guideline includes some important changes which could lead to a tripling of the wealth tax.

Subject of the Guideline

The tax basis for the wealth tax depends not only on the existence of assets, but also on how they are valued. The wealth tax, which is imposed by the cantons and municipalities, is based on total net assets. The assets are valued at market value (*Verkehrswert*), although a capitalised earnings value (*Ertragswert*) can, in an appropriate manner, also be used. Securities are valued at their securities exchange trading prices and, if they are not traded on an exchange, then at fair market value or intrinsic value (*innerer Wert*). The valuation is normally performed by the tax authorities in the canton where the company to be valued has its domicile.

Because there are no detailed regulations for valuation in the tax laws, the authorities use the methods in the guideline as guidance for the determination of market value. In this way, a uniform valuation of securities should be assured and tax harmonisation among the cantons should be promoted.

The subject of the guideline is the valuation of those domestic and foreign securities which are not traded or which are only traded infrequently and for which, therefore, a price history, as a measure of market value, does not exist.

Changes

The most important changes are to be found in relation to the valuation of trading, industrial and service companies.

Because assets are generally valued at market value and the transaction prices which result under normal conditions are considered market value, intrinsic

value must be used for securities that are not listed on a securities exchange and for which there is no trading price. The valuation rules in the new guideline are used for the determination of the intrinsic value. In contrast, in the case of listed securities, the closing price on the last securities exchange trading day during the relevant tax period is used.

The enterprise value (*Unternehmenswert*) continues to be calculated under the new guideline in accordance with the average value procedure (*Mittelwertverfahren*), also known as the practical method (*Praktikermethode*), and is the result of the sum of twice the capitalised earnings value and the going-concern value (*Substanzwert zu Fortführungswerten*), divided by three.

What is new – and this is the subject of debates – is that the going-concern value is considered to be the minimum value. In the past, the formula “the result of the sum of twice the capitalised earnings value and the going-concern value, divided by three” was also applied if the capitalised earnings value was less than the going-concern value. It was possible to have a result that was less than the going-concern value. If the capitalised earnings value was zero, then the result was one-third of the going-concern value.

The new rules in the guideline have the consequence that a business will be valued at no less than going-concern value, even if the capitalised earnings value is very low or negative.

To justify this, it is stated that the previous rule was inconsistent with the statutory requirement that assets are to be valued at market value.

Now there are two models for the calculation of the capitalised earnings value:

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- under the first model, the income statements for the past two financial years are the basis for the calculation. In this case, the adjusted net profit of the most recent financial year is double weighted.
- under the other available model, the income statements for the last three financial years can be used and the adjusted net profit (*korrigierter Reingewinn*) of all three financial years is single weighted.

Each canton adopts one of the two models as the cantonal standard. If the company wants to depart from the chosen model, it can select the other model. The company is required to use the selected model for the next five financial years. As a result, there is a need for planning because the method chosen can have an effect on the relevant value of the business.

There is a further change in the determination of the capitalisation rate for the calculation of the capitalised earnings value of the business. The capitalisation rate is higher than in the previous rules, which will lead to a lower capitalised earnings value. This rate is composed of a variable interest rate for risk-free investments derived from the swap rate and a fixed risk premium of 7%. The previous 30% lump-sum risk deduction (*Risikopauschale*) for general entrepreneurial risk is therefore obsolete. The applicable capitalisation rate will be published annually by the Federal Tax Administration and amounts to 10.5% for 2008.

There are new rules for taking into account latent taxes, as well as the application of the guideline to domicile companies and mixed companies, which now are to be valued in the same manner as trading, industrial and service companies.

Entry into force

The new guideline already applies for valuations based on financial statements for periods ending after 1 January 2008, in other words, as of the 2008 tax year with the applicable tax procedures in 2009. Assets are valued as of the end of the tax period or when the obligation to pay tax ends. The market value of a security as of 31 December of the year of the tax period is to be used. The exception is the new rule under which the minimum value is the going-concern value. This rule applies, however, only to valuations based on balance sheet dates after 1 January 2011.

Outlook

Trading, industrial and service businesses will be especially affected. There were urgent requests from

various parties for the new guideline to be abandoned, but these were ignored. The Association of Private Corporations (*Vereinigung privater Aktiengesellschaften*), with which the changes had been discussed, considered the introduction and implementation of the new guideline as an increase in the tax burden for a majority of small and mid-sized businesses.

The new guideline will lead to higher valuations – as from the 2011 tax year – in situations in which the capitalised earnings value is lower than the going-concern value. We will have to wait and see how matters develop in the application of the new guideline. It cannot be ruled out that the cantons will adopt rules for the application of the new regulations. The circular letter is a recommendation to the cantonal tax authorities for the uniform application of the tax laws. The cantonal tax authorities will determine in their own judgment how it is applied.

The ww&p NewsLetter provides comments on new developments and significant issues of Swiss law. These comments are not intended to provide legal advice. Before taking action or relying on the comments and the information given, addressees of this NewsLetter should seek specific advice on the matters which concern them.

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