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Federal Supreme Court Rules on VAT Treatment of Re-sale of Treasury Shares

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In a judgment rendered on 5 October 2021 (case 2C_891/2020), the Swiss Federal Supreme Court upheld the decision by the Federal Administrative Court of 18 September 2020 (case A-7028/2018), which had found that the proceeds realized by a Swiss corporate VAT taxpayer from the resale of a position of its own stock ("treasury shares") did not fall within the scope of Swiss VAT, i.e. constituted a "non-turnover". Therefore, such proceeds are treated in the same fashion as the proceeds from a shareholder capital contribution received for the issuance of new shares. The VAT treatment as capital contribution ("out of scope" flow of funds) meant that the taxpayer's ability to deduct input VAT suffered in connection with the re-sale of treasury shares remained unaffected.

Facts of the case

The case concerned a holding company ("HoldCo") which was registered as a Swiss VAT taxpayer. During the years 2012-15 HoldCo had claimed input tax credits for Swiss VAT suffered on charges for professional advice received in connection with the resale of treasury shares. The Swiss Federal Tax Administration (SFTA) denied the deduction of input VAT suffered, arguing that the proceeds from the re-sale of treasury shares constituted VAT-exempt turnover from the sale of financial instruments (shares), against which no input VAT can be credited (the presence of VAT-exempt turnover next to taxable turnover generally leads to a proportional reduction of the deduction or credit for input VAT suffered by the taxpayer).

Considerations of the Federal Administrative Court

HoldCo filed an appeal against the SFTA's final decision to the Federal Administrative Court (FAC). The ultimate question to be answered by the court was whether HoldCo was entitled to claim a full deduction of its input VAT suffered during the relevant periods from its output VAT liability on taxable supplies. Generally, art. 29 (1) of the Swiss federal VAT Act excludes the deduction (or credit) of Swiss input VAT suffered on the purchase of domestic supplies of goods or services, as well as on imported goods or services, where such goods or services are used for performances that are exempt from VAT

according to art. 21 VAT Act, and for which no voluntary VAT inclusion pursuant to art. 22 VAT Act was opted for by the taxpayer. (Although the turnover from transfers of shares is principally exempt from VAT and leads to a reduction of input VAT credits or deductions, input VAT may nonetheless be deducted where the turnover derives from the sale of a qualifying participation, i.e. an equity stake of at least 10% held for investment purposes – see art. 29 (2) and (3) VAT Act.)

The FAC stressed that VAT generally applies to mutual relations providing for a performance in exchange for a consideration. Anyone who independently runs an enterprise for own account with external visibility in view of continuously deriving revenues is principally subject to VAT liability, unless the annual turnover from taxable supplies of goods or services in Switzerland and abroad is less than CHF 100,000 (art. 10 VAT Act). Domestic supplies of goods or services by taxable persons for consideration are subject to VAT, unless they fall under a specific statutory exemption (art. 18 (1) VAT Act). In order for VAT to apply, there must be a (taxable) supply or performance, a consideration, and an economic nexus between the two. The supply or performance has three components: (a) granting of a consumable economic value, (b) to a recipient, and (c) with the expectation of receiving a consideration in return. All of that has to be analyzed from the perspective of the supplier/performer. The consideration describes the asset or value, which the recipient (or a third person on the recipient's behalf) provides in return for the supply or performance. Whether this asset or value constitutes a consideration is to be analyzed from the perspective of the recipient of the supply or performance. Finally, there must be a sufficient nexus between the supply and the consideration. The consideration must be triggered by the supply or performance. The economic nexus is established based on the perspective of the recipient of the supply or performance.

Swiss jurisprudence draws a distinction between certain turnovers that are derived from a supply or performance and are thus principally "in scope" of VAT, but are exempt from VAT under a specific statutory exemption pursuant to art. 21 VAT Act, such as certain types of turnover derived in the money and capital markets (art. 21(2)(e) VAT Act) – in particular, turnover from the transfer or intermediation of securities, de-materialized securities and financial derivatives, as well as corporate shares including fiduciary transactions (art. 21 (2) no. 19 letter e VAT Act) – and situations involving a flow of funds, which are, however, not characterized by an exchange of a supply or performance for a consideration, and which are, therefore, "out of scope" of the VAT legislation. "Out of scope" are in particular flows of funds that are not linked to any relevant supply or performance. Art. 18 (2) VAT Act contains a list of examples for such "out of scope" flows, among them in particular public subsidies and contributions, as well as dividends and similar profit shares or distributions (letter f) and *capital contributions granted to enterprises*, including interest-free loans, contributions in the context of a financial restructuring and debt waivers

(letter e). “Out of scope” flows are not consideration in the meaning of the VAT Act.

The FAC held that the notion of “capital contribution” should be interpreted widely. It includes any types of shareholder contributions, paid-up share premium (especially in connection with the issuance of new shares upon a capital increase) and informal contributions for no consideration, waivers of shareholder loan principal and interest accrued thereon. Furthermore, the FAC stressed that the VAT analysis of transactions has to adopt an economic, rather than a merely formal, legal approach. Both the legal form and the accounting aspects of a transaction may serve as indications for the correct VAT treatment; however, they do not replace a thorough analysis of the economic content.

In terms of relevant underlying facts, the FAC found that HoldCo had sold or “re-issued” treasury shares which it had previously acquired in two different fashions: While some of the treasury shares were “originary”, i.e. had been directly subscribed and acquired by HoldCo itself as new shares in the context of a formal capital increase, other treasury shares were “derivative” or “secondary”, i.e. had been repurchased by HoldCo as existing shares from its shareholders. The FAC had to decide whether the proceeds from the sale or re-issuance “originary” and/or “derivative” treasury shares constituted VAT-exempt turnover from trade of securities (as had been represented by the SFTA), or rather an “out of scope” flow of funds, in particular, a capital contribution pursuant to art. 18 (2) letter e VAT Act.

In answering the question, the FAC referred to economic doctrine, according to which the acquisition by a company of its own shares ought to be viewed primarily as a return of equity. That approach was specifically adopted by a revision of Swiss statutory accounting rules as, which came into effect as of 1 January 2013. While under the previous law, treasury shares had to be capitalized as an asset on the company’s balance sheet and “neutralized” through a special reserve for own shares, the current law (art. 959a (2) no. 3, letter e of the Swiss Code of Obligations (CO)) does no longer provide for the statement of treasury shares as an asset. Instead, the new law requires the reflection of treasury shares as a negative equity position in the amount of the acquisition cost. Thus, the acquisition of treasury shares is effectively treated as equivalent to a share capital reduction, or capital repayment. Accordingly, Swiss legal commentators have concluded that the re-sale or re-issuance of treasury shares is not to be regarded as a transfer of a valuable asset from the company’s perspective, but rather as a contribution to the company’s equity. Accounting-wise, this is reflected by a dissolution of the negative equity position. Gains or losses upon the re-issuance of treasury shares are to be reflected directly in the capital account, not through the income statement.

The FAC concluded that the (re)sale or re-issuance of treasury shares leads to the same economic result as a sale of new shares in the context of a formal

capital increase. Both transactions directly result in an increase of the company's equity. Therefore, the sale of treasury shares (whether "originary" or "derivative") has to be characterized as an equity financing transaction, which falls under the notion of "capital contribution" in the meaning of art. 18 (2) letter e VAT Act. Capital contributions are not consideration for VAT purposes; hence they constitute "out of scope" flows rather than VAT-exempt turnover. Accordingly, there was no reason for a reduction of input VAT credits.

Ruling of the Federal Supreme Court (FSC)

Upon an appeal filed by the SFTA, the FSC confirmed the decision of the lower court. The FSC reiterated that taxable supplies or performances include supplies of goods as well as supplies of services for consideration. Sales of shares may principally qualify as transfers of intangible assets for consideration, i.e. supplies of a service.

However, funds derived by a corporation from its shareholders in connection with the initial issuance of shares upon formation or pursuant to a subsequent share capital increase are qualified as capital contributions (i.e. "out of scope" flow of funds or "non-turnover") in the meaning of art. 18 (2) letter e VAT Act. The FSC referred to similar European VAT law and the jurisprudence of the ECJ, which, while not binding upon Swiss courts, can be used as a source of interpretation where Swiss VAT law does not expressly and intentionally deviate from the VAT Directives of the European Union. Specifically, the FSC referred to the ECJ's judgment of 26 May 2005 in the matter of *Kretztechnik* (C-465/03), as well as the ECJ ruling of 26 June 2003 in the matter of *KapHag* (8C-442/01) which concerned the VAT treatment of a partner contribution to a partnership, as well as ECJ jurisprudence (in particular, judgment of 13 June 2018 in the matter of *Polfarmex*, C-421/17) according to which the redemption by a company of its own shares does not constitute an entrepreneurial activity and is thus "out of scope" of the EU VAT Directives.**[1]** Referring to predominant Swiss legal doctrine and revised Swiss accounting law, the FSC argued that, as treasury shares do not constitute an "asset" of the company, the re-issuance or sale of treasury shares is not to be viewed as a transfer of an (intangible) asset, but rather as a flow of funds to the company equivalent to a capital contribution made by a shareholder upon a capital increase. The company effectively raises its net assets or equity upon the re-sale of its own shares. The buyers of the treasury shares invest directly in the company's equity, as is the case in the situation of a formal capital increase. The FSC sees no relevant difference to a formal capital increase. Any book gain or loss arising upon the sale of treasury shares is to be recorded directly in the capital account pursuant to revised statutory accounting rules, which in that respect are consistent with IFRS accounting standards (IAS 32.33).

Given that the proceeds derived by HoldCo from the re-sale of its own shares were considered flows of funds that are "out of scope" of Swiss VAT (capital contributions), the FSC found no reason to reduce HoldCo's claims for input VAT credits.

Brief Comment

The decisions of the Swiss courts are to be welcomed, as they are consistent with revised Swiss accounting rules and with the jurisprudence of the ECJ on European VAT matters, which are primarily taking economic realities into account. The clarification concerns in particular Swiss private as well as publicly held holding and investment companies that engage in purchasing and selling activities in their own shares for a variety of objectives, such as management by a listed company of its own stock price, operation of an employee stock participation program, and other treasury activities. Swiss law generally allows for the acquisition and holding of treasury shares of up to 10% of the entire issued share capital.

It is not yet entirely certain at this point whether the "economic" and accounting-based approach adopted by the Swiss courts in VAT matters will be ultimately confirmed for direct (corporate income) tax purposes as well. Realized book gains and losses on treasury shares should consequently be excluded from taxable net profits, as the entire proceeds from a sale of treasury shares ought to be qualified as a capital contribution. Swiss direct tax laws explicitly exclude capital contributions from taxable income.

[1] It should be noted, however, that the *Polfarmex* case involved a redemption of some of Polfarmex's shares in exchange for the delivery of certain real estate assets. The ECJ ruled that, while the redemption of the shares did not constitute an entrepreneurial activity, the transfer of the real estate assets in return could constitute a taxable supply, if the assets were used for the entrepreneurial activities of the transferring entity.