

Update

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Tax deductibility of fines

The Swiss Federal Supreme Court has ruled that fines and other sanctions of a criminal nature are not tax deductible for legal entities, as they are not deemed to be business-related expenses. Tax deductibility is only granted insofar as sanctions aim at disgorging illegally obtained profits. The ruling, which was rendered in a case of violations of competition laws, has far-reaching implications in other areas.

Background of the decision

The Swiss Federal Supreme Court (the "Court") had to decide on the deductibility of a fine of EUR 348'000 imposed in 2009 on a Swiss company by the European Commission for carrying out administrative activities in connection with cartel agreements. Subsequently, the company provisioned an amount of CHF 460'000.

In 2013, the Zurich Tax Appeals Commission admitted the deduction of the provisions from the taxable net profits and net equity, which was confirmed by the Zurich Administrative Court.

Upon appeal by the Zurich Tax Authority, the Federal Supreme Court reversed the cantonal court's decision.

Deductibility of business-related expenses

Under Swiss law, business-related expenses are tax deductible for legal entities. Therefore, the key question was to determine whether the fine in question would qualify as a business-related expense. As for tax fines, the law explicitly determines non-deductibility for income tax purposes.

Fines and sanctions of criminal nature

Initially, the Court reasoned that the non-deductibility of fines and other financial sanctions of criminal nature imposed on legal entities (stock companies and other capital companies, cooperatives, associations and foundations) on their personal responsibility results from an interpretation of law: if said fines were tax deductible, the community would indirectly be held responsible for a part of the fine imposed on a legal entity which would run afoul of the intended punitive effect. For reasons of consistency and uniformity of the legal order, such an influence of tax law on criminal law is not intended, so the Court.

Furthermore, the Court held that as the law currently stands, payments made for corruption purposes are not tax deductible, and corruption itself is a criminal act. It would be paradoxical to deny tax deductibility for such payments, but to admit it with respect to fines for corruption actually committed.

The Court also stated that as it had decided in previous cases that fines imposed on self-employed individuals are not deemed to be business-related expenses. A privileged treatment of legal entities is not justified, in particular because Swiss competition law fines are imposed regardless of the legal or organizational form of

the sanctioned person. Thus, if the fine imposed due to an identical infringement was deductible for a legal entity, but not for a self-employed individual, the principle of equal treatment would be violated.

Finally, the Court held that the non-deductibility of fines and administrative sanctions of criminal nature was compatible with the principle of taxation based on economical capacity.

Profit disgorgement sanctions

However, the Court admitted that fines or sanctions aiming at disgorging illegally obtained profits are deemed to be business-related expenses and thus tax deductible. Such a sanction does not have criminal or punitive purposes, but aims at correcting an unlawful situation.

In the reported case, the Court referred the matter back to the lower court in order to examine whether the imposed fine was of pure criminal nature, or whether a part of it represented a profit disgorgement sanction.

According to this landmark case, it is thus essential for Swiss income tax purposes to distinguish fines with a penal nature from sanctions aiming at disgorging illegally obtained profits. In its decision, however, the Court did not provide any specific guidance on how to distinguish one from the other.

The principle established by the Swiss Federal Supreme Court is likely to apply also to other sanctions by Swiss or foreign authorities such as penalties under the US-Swiss banking program, FINMA fines or Swiss anti-trust fines.

In this context, it may be noted that the Swiss parliament aims at establishing an explicit legal basis for this question: A draft bill submitted to parliament for discussion provides that financial administrative sanctions of criminal nature as well as the related cost of proceedings will not be deductible while profit disgorgement sanctions of non-penal purpose will be deductible.

Please do not hesitate to contact us in case of any questions.

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