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Corporate taxes: Deducting COVID-19 costs already in 2019?

26.03.2020

The coronavirus crisis leaves companies facing not only falling income, but also additional expenses on top. Companies should therefore examine to what extent additional expenses incurred in connection with the coronavirus crisis are already tax-deductible in the financial year 2019.

Key takeaways

- Companies that incur additional costs due to the coronavirus crisis should explore whether this expense can be anticipated already in the 2019 annual financial statements in the form of a tax-deductible accrual.
- Besides an accrual, companies should also check whether any other tax-deductible write-downs could be possible. Potential items include production materials, inventories of goods or accounts receivable.

How is a tax-deductible expense connected to the financial year?

A company's taxable profit is the profit generated in a given financial year. Therefore, only expenses relating to that financial year can be deducted for tax purposes. Expenses incurred in the subsequent financial year may only be deducted in that subsequent financial year.

This can lead to situations where profits from year 1 are taxed even though excess expenses (loss) are incurred in year 2. Unlike tax laws prevailing in some other countries, Swiss tax law does not provide for tax loss carrybacks. Although tax loss carryforwards are permissible, they impair, at a minimum, the company's liquidity situation.

What may be possible, however, is to anticipate future expense by recognising a tax-deductible accrual. This enables, for example, expenses to be recognised for tax purposes already in year 1, even if the cost positions are not in fact realised until year 2.

In this scenario, it is critical to establish whether the criteria for setting up a tax-deductible accrual are met.

How are tax-deductible expenses connected to the financial reporting?

Unlike tax laws prevailing in some other countries, Swiss tax law considers the statutory standalone financial statements decisive for determining taxable profit. This means that if the applicable accounting law allows for accruals to be set up, then the corresponding accrual would, in principle, also be accepted for corporate income tax purposes:

For tax purposes, it is essential that the accrual position in the specific case at hand is demonstrably an expense by nature from the perspective of the affected company and not merely a reserve fund.

The same principles also apply in reverse: an expense may only be deducted for tax purposes provided that the expense was recognised in the statutory standalone financial statements. An exception to this rule may only be considered if a company failed to recognise an accrual that was not only permissible but mandatory, meaning that there is a misstatement in the financial statements without that accrual.

What are the criteria for setting up an accrual?

Accruals are liabilities or obligations recognised through profit and loss when the exact amount and/or due date are still uncertain.

The balance sheet date is the relevant date for assessing whether to set up an accrual. Therefore, it is important to distinguish between events that occurred after the balance sheet date, but whose causes were already in existence as of that date, and events triggered after the balance sheet date.

If the cause of an event already existed as of the balance sheet date, then that event has to be recognised in the financial statements of the past financial year. If the cause developed after the balance sheet date, the principle does not allow for the event to be recognised in the financial statements. Instead, it should be disclosed as a subsequent event in the notes to the financial statements.

In order to assess the question of whether an event had already been triggered as of the balance sheet date, all information received at the time of preparing the balance sheet may be used. Since the process of preparing the balance sheet can only take place after the end of a financial year, it is permissible for the company to use information that it receives in the new financial year. This, on the proviso that the subsequently received information sheds light on a situation already in existence in the past as of the balance sheet date (i.e., event after the reporting period that provides further evidence of conditions that existed at the end of the reporting period).

The company is free to choose its own financial year. The calendar year (ending 31.12.) is a popular choice. In the context of the current coronavirus crisis, the question therefore is whether a company may recognise accruals for corona-related additional expenses in the annual financial statements as of 31.12.2019. Additional expenses could include things like extended storage times or spoilage of stocks or unsaleable goods, security and hygiene measures, additional salary costs, measures to rearrange work organisation, legal advice and disputes, informing customers and indemnification, etc.

Is the crisis triggered by COVID-19 an event occurring before or after a balance sheet date ending 31.12.2019?

The first cases of people falling ill with coronavirus were already registered in early December 2019 (in the city of Wuhan, China). The WHO was informed of cases of pneumonia with an unknown cause in the Chinese city of Wuhan on 31 December 2019. This was the start of a global pandemic.

On 30 January 2020, the situation had escalated to the extent that the Director-General of the WHO announced the outbreak of the coronavirus to be a public health emergency of international concern. This outbreak of disease was the same one that began in China in December 2019.

At an extraordinary meeting on 28 February 2020, the Swiss Federal Council declared an ‘extraordinary situation’ in accordance with the Swiss Epidemics Act and issued a temporary ban on large events. Here, again, the situation relates to the same outbreak that began in China in December 2019. In the meantime, more stringent measures have been implemented in Switzerland and the disease has become a global crisis.

In initial statements from certain tax authorities, the crisis triggered by COVID-19 is considered by some to be a subsequent event (i.e., occurring after the balance sheet date) in relation to the annual financial statements as of 31.12.2019.

On the other hand, it remains a fact that the outbreak of the disease – the cause for the development of this pandemic – had already occurred in December 2019. The crisis triggered by COVID-19 is also based on this same outbreak of disease.

Companies that incur additional expenses in connection with the coronavirus crisis should therefore explore the possibility of recognising an accrual for the financial year 2019. Besides an accrual, companies should also check whether any write-downs could be possible. Potential items include production materials, inventories of goods or accounts receivable.

If they have one, companies should involve their statutory auditor in these questions. Companies should also proactively approach the relevant cantonal tax authorities regarding this issue.

Have there been similar situations in the past?

There was a somehow similar (even though not identical) issue in 2015. On 15 January 2015, the Swiss National Bank (SNB) announced that it would discontinue market measures to maintain a minimum CHF-EUR exchange rate. As a result, companies made losses on their positions denominated in euro.

The question back then was whether this event could be considered in the previous financial statements, i.e., already in 2014, or not. At the time, various cantonal tax authorities published statements indicating that they would accept accruals for the economic impact of discontinuing the minimum CHF-EUR exchange rate (provided certain criteria were met and without prejudice).

In contrast to the current crisis triggered by COVID-19, the SNB's decision to lift the CHF-EUR exchange rate floor, did not become known until after the prior-year cut-off date of 31.12. The coronavirus outbreak existed already prior to 31.12., and the existence of the coronavirus outbreak was already known prior to 31.12. The pandemic currently under way relates to the same outbreak.

Need for action?

Companies that incur additional expenses in connection with the coronavirus crisis should examine whether and to what extent these expenses are already tax-deductible in 2019. To achieve this, they should consider whether setting up an accrual in the 2019 annual financial statements may be possible. Besides an accrual, companies should also check whether any write-downs could be possible. Companies should proactively approach the relevant cantonal tax authorities to discuss this topic.

No legal or tax advice

This legal update provides a high-level overview 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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