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Asymmetric dividend distribution – increased risk of reclassification

Introduction

A recent ruling by the Swiss Federal Court highlights the significant risk of an asymmetric dividend distribution being reclassified as employment income subject to social security contributions.

Issue

In certain situations, the shareholders of a joint-stock corporation may wish to deviate from the provisions of the Swiss Code of Obligations stipulating that profit distributions must be made in proportion to each shareholder's contribution (see Articles 660 and 661 of this Swiss Code of Obligations). As these articles are non-mandatory, shareholders may stipulate in the company's articles of association that asymmetrical distribution of dividends are permitted. This may result from a desire to remunerate the increased risk taken by a shareholder who injects funds into the company as part of a restructuring process. Furthermore, in many SMEs, shareholders also have a role within the company as employees and receive a salary. However, given the partial taxation of dividends for shareholders holding more than 10% of the shares and the fact that dividend distributions are not subject to social security contributions, it is tempting to receive remuneration in the form of dividends rather than employment income. In such cases, the compensation offices generally reclassify any dividend exceeding 10% of the tax value of the shares as salary (see Guidelines on the relevant salary for AHV, IV and EO purposes (WML)).

Recently, the Swiss Federal Court handed down a ruling on a Lucerne-based SME that regularly distributed the company's profits to its four shareholders on an asymmetrical basis, according to their individual productivity within the company (turnover, acquisition of mandates, etc.). An audit by the cantonal compensation office resulted in these dividends being reclassified as wages subject to social security contributions for almost all of the distributions made (ATF 9C_272/2024).

Classification criteria

In the above-mentioned case, the Federal Court ruled in favour of the compensation office, holding that the key criterion is the economic function of remuneration. A salary is intended to remunerate work performed, whereas a dividend remunerates

capital. Remuneration based on personal turnover and the acquisition of mandates is clearly to be regarded as remuneration for work, since these are productivity criteria that would be expected of these individuals regardless of their status as shareholders of the company.

The Federal Court nevertheless upheld the cantonal court's position that the entire dividend should not be reclassified because, statistically, shareholders of Swiss companies are entitled to a dividend of 2.5% of the company's capital. It was therefore held that shareholders should have received a symmetrical dividend distribution in this respect.

It is interesting to note that our High Court thus departed from the practice whereby, in principle, only the portion exceeding 10% of the tax value should be reclassified under the WML and the relevant case law, arguing that this practice applies to so-called symmetrical dividend distributions.

Consequences

If a dividend is reclassified as salary, the compensation office will collect contributions on the reclassified amounts and charge interest on arrears at a rate of 5%, which can lead to substantial amounts.

Conclusion

Shareholders working in their own companies must be mindful of the balance between their remuneration in the form of salary and that in the form of dividends. The issue is particularly sensitive if asymmetric dividend distributions are planned, in which case a solid justification unrelated to the shareholder's work is required.

Please do not hesitate to contact us if you have any questions.

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