CAPITAL INCREASE FROM FREELY DISPOSABLE EQUITY – AN OVERVIEW

KEY POINTS AT A GLANCE

- A capital increase from freely disposable equity under Article 652d of the Swiss Code of Obligations (CO) enables a Swiss stock corporation (Aktiengesellschaft) to convert existing freely disposable equity into share capital.
- In principle, this requires up-to-date audited annual financial statements or interim financial statements, together with a positive assurance from the auditors, to serve as proof of coverage.
- In its Practice Notice (Praxismitteilung) 2/26 of 9 June 2026, the Federal Commercial Registry Office (Eidgenössisches Handelsregisteramt, EHRA) clarified the requirements for proof of coverage.
- These clarifications are of particular and practical relevance to companies subject to a limited audit or that have opted out of an audit.
- From a tax perspective, the choice of the equity capital positions used for the conversion is decisive: converting retained earnings reserves has withholding tax and income tax consequences (as bonus shares), whereas converting capital contribution reserves remains tax neutral.

GENERAL PRINCIPLES

In practice, a capital increase usually involves the injection of new funds, namely cash or contributions in kind. However, under Article 652d CO, the share capital of a stock corporation can also be increased by **converting freely disposable equity**. Unlike, for example, a cash capital increase, this does not provide the company with any **new funds**. Rather, the newly created share capital is paid up in favour of the existing shareholders using the company's existing freely disposable equity. The new shares are allocated to the existing shareholders in proportion to their current shareholding, without any obligation on their part to pay up the shares. The procedure is therefore also referred to as the creation of "**bonus shares**". Instead of issuing new shares, the capital increase may also be implemented by increasing the nominal value of the existing shares.

From an economic and accounting perspective, this is purely a **reallocation of equity**: the share capital increases, whilst the freely disposable equity positions are reduced accordingly. Neither the amount of equity nor the balance sheet total is affected. This form of capital increase is therefore particularly suitable for **capitalising reserves** without shareholders having to contribute additional funds.

PROOF OF COVERAGE

Freely Disposable Equity

As mentioned, the distinctive feature of a capital increase from freely disposable equity is that no new funds flow into the company. This makes it even more important that the equity capital positions used are in fact freely disposable. Proof that the amount of the increase is covered and that it is freely disposable (the so called "**proof of coverage**") is therefore of central importance.

Equity is classified as **freely disposable** if the reported equity is not restricted either by law or by the articles of association and is not frozen based on the specific balance sheet situation (in particular, the absence of over-indebtedness). Put simply, only that part of the equity that remains as **distributable retained earnings or distributable reserves** after covering losses, complying with statutory retention ratios and observing restrictions under the articles of association on the use of funds, is freely disposable.

By law, the amount of any capital increase drawn from freely disposable equity must be confirmed by annual accounts approved by the general meeting of shareholders and audited by a licensed auditor. The starting point is therefore always the provision of **audited annual financial statements** approved by the general meeting, serving as proof of coverage (Article 652d paragraph 2 CO). These must have been audited by a licensed auditor (Article 652d paragraph 2 number 1 CO). If the balance sheet date is more than six months before the date of the general meeting's resolution, **audited interim financial statements** must be obtained (Article 652d paragraph 2 number 2 CO in conjunction with Article 960f CO).

Dispute Over Proof of Coverage and Audit Standards

The exact wording of the proof of coverage (i.e., the annual or interim financial statements and the audit report) has long been disputed. The core issue is that a **limited audit** only provides a **negative assurance** under Article 729a CO, the auditor merely confirms that nothing has come to their attention suggesting non-compliance. A **standard (ordinary) audit**, by contrast, requires the auditor to issue a **positive assurance** that the financial statements comply with the applicable rules (Article 728a paragraph 1 number 1 CO).

As early as 2020, the EHRA clarified that the proof of "coverage of the increase amount" must take the form of a positive audit opinion (REPRAX 1/2020, p. 111). A negative assurance resulting from a limited audit does not satisfy the requirements of Article 652d paragraph 2 CO. Annual financial statements subject to an ordinary audit always provide sufficient proof of coverage.

New EHRA Practice Notice

In the EHRA's view, **annual financial statements subject to an ordinary audit** always provide positive assurance and thus sufficient proof of coverage.

It remained unclear, however, how this applied to **companies subject to a limited audit** (Article 727a paragraph 1 CO) or to **companies that have opted out of an audit** (Article 727a paragraph 2 CO). The new EHRA Practice Notice 2/26 now clarifies the requirements:

- **Limited audit companies**: Where a capital increase is based on annual or interim financial statements subject to a limited audit, the auditor must carry out **additional audit procedures** covering, at a minimum, the unrestricted disposability of the equity to be converted, and must provide a **positive assurance** in this regard.

- **Opt-out companies**: The annual or interim financial statements must first be subject to at least a limited audit. In addition, the same supplementary audit procedures and positive assurance requirements apply as for limited audit companies.

Mandatory Auditor's Statement for Financial Statements Subject to a Limited Audit

After consultation with the Federal Audit Oversight Authority (RAB), the EHRA requires that, for financial statements subject to a limited audit, the auditor's report under Article 652f paragraph 1 CO must, in addition to confirming completeness and accuracy, include the following **written statement**: "*Additional audit procedures were carried out in accordance with the Swiss Standards for Other Auditing Services.*" If this statement is missing, the application is likely to be rejected by the cantonal commercial register office.

Resolution of the General Meeting

The general meeting of shareholders resolves on the capital increase by means of a **resolution to be recorded in a notarised public deed, passed by a qualified majority** in accordance with Article 704 paragraph 1 number 3 CO. The notarial deed must explicitly state that the newly issued share capital is to be paid up by converting freely disposable equity.

Capital Increase Report and Auditor's Confirmation

The board of directors determines which **equity capital positions** are to be converted into share capital and verifies that they are freely disposable. In doing so, particular consideration must be given to loss carry-forwards, statutory reserves, restrictions under the articles of association, treasury shares and other restrictions under capital protection rules.

The board of directors then draws up a **capital increase report** (Article 652e number 3 CO). In this report, it sets out why the equity capital positions to be converted are freely disposable and that the amount of the increase is fully covered.

A licensed auditor confirms, in a **written auditor's confirmation**, that the capital increase report is complete and accurate (Article 652f paragraph 1 CO).

The capital increase report prepared by the board of directors and the accompanying auditor's confirmation from a licensed auditor supplement the audited annual financial statements as proof of coverage, in that the board of directors justifies the free disposability of the equity capital, and the auditor confirms the completeness and accuracy of the report.

In practice, it was often unclear what role the audit report on the annual financial statements and the auditor's confirmation on the capital increase report played. The EHRA Practice Notice 2/26 now clarifies that, whilst the proof of coverage and the auditor's confirmation on the capital increase report do overlap in terms of content, they serve **different purposes** (namely with regard to their subject matter of the audit and their legal function) and must therefore not be treated as equivalent. However, both address the same underlying question of whether the equity used for the capital increase is genuinely freely disposable.

In the EHRA's view, the audit report on annual financial statements subject to an ordinary audit always provides a positive assurance and is therefore sufficient basis for the auditor's confirmation accompanying the capital increase report. As this is not the case with a limited audit of the annual financial statements, the audit report on these annual financial statements must be supplemented by additional audit procedures and the mandatory confirmatory note.

Type of Audit	Assurance (Annual Financial Statements)	Additional Audit Procedures	Mandatory Confirmatory Note
Ordinary audit	Positive	No	No
Limited audit	Negative	Yes	Yes
Opting-out	At least a limited audit required = Negative	Yes	Yes

Board Resolutions Confirming Implementation of Capital Increase and Amending the Articles of Association

Once the capital increase has been carried out, the board of directors confirms that the capital increase has been implemented in a resolution which must again be **publicly notarised.** It further amends the **provisions of the articles of association** relating to the share capital.

Commercial Register Filing and Registration

Finally, the necessary documents are filed with the respective cantonal **commercial register office** for registration of the capital increase. The capital increase only takes effect upon publication in the Swiss Official Gazette of Commerce (Article 936a paragraph 1 CO).

In accordance with the Commercial Register Ordinance (CRO), the commercial register application must be submitted with the **capital increase report** together with the **auditor's confirmation** (Article 46 paragraph 3 letter b CRO) and the **proof of coverage** (Article 46 paragraph 3 letter c CRO).

The **entry in the commercial register** must expressly indicate that the capital increase was carried out by converting freely disposable equity (Article 48 paragraph 1 letter i CRO).

SUBSEQUENT PAYING-UP WITH FREELY DISPOSABLE EQUITY

A distinction must be made between a capital increase from freely disposable equity and the subsequent paying-up of existing shares or participation certificates not fully paid up, under Article 634b CO or Article 656a paragraph 2 CO in conjunction with Article 634b CO. Freely disposable equity may also be used for such subsequent paying-ups (Article 634b paragraph 2 CO). What both processes have in common is the requirement to prove that the equity capital positions used are genuinely freely disposable.

The key difference lies in the outcome: in the case of a capital increase the nominal share capital is increased. In the case of paying-up shares, the nominal amount of the existing share capital remains unchanged. Only the degree to which the already issued shares have been paid up increases.

Where freely disposable equity is used for a subsequent paying-up, its free disposability must be demonstrated and documented in the same way as for a capital increase from freely disposable equity.

TAX ASPECTS

At company level, a capital increase from freely disposable equity is neutral for corporate income tax purposes, since it merely reallocates funds within equity. What matters for tax purposes is which equity capital positions are converted. Where **retained earnings reserves** (out of taxed profit) are converted into share capital, the resulting bonus shares or bonus nominal value increases are treated as a taxable benefit in kind and are subject to **withholding tax at a rate of 35 %** (Article 4 paragraph 1 letter b Withholding Tax Act in conjunction with Article 20 paragraph 1 Withholding Tax Ordinance). Since the company does not receive any funds, the tax must either be passed on to the shareholders or borne by the company (grossed up to 100 %); the availability of the notification procedure should be assessed.

For a **shareholder** holding the shares as private assets, the allocation constitutes taxable investment income (Article 20 paragraph 1 letter c Federal Direct Tax Act; partial taxation applies for qualifying participations). If, by contrast, **capital contribution reserves (CCR)** are converted, neither withholding tax nor income tax applies (Article 5 paragraph 1bis Withholding Tax Act and Article 20 paragraph 3 Federal Direct Tax Act, respectively), provided the CCR have been recorded separately under commercial law and reported to the Federal Tax Administration (ESTV); in that case, the resulting capital remains repayable tax free up to its nominal value.

In addition, the increase in nominal value is, in principle, subject to **issuance stamp duty at a rate of 1 %** (Article 5 paragraph 1 letter a Stamp Duty Act). The CHF 1 million exemption threshold (Article 6 paragraph 1 letter h Stamp Duty Act) applies only to equity securities paid up against consideration and therefore does not apply to bonus shares. No issuance stamp duty is levied, however, to the extent the equity capital converted is capital on which the duty has already been paid (for example, CCR originally paid in as share premium).

CONCLUSION AND RECOMMENDATIONS

The EHRA Practice Notice 2/26 does not alter the legal basis for capital increases from freely disposable equity. It does, however, clarify the requirements for proving coverage of the increase amount and provides greater clarity, especially for companies subject to a limited audit and for those companies that have opted out of an audit.

The key issue is how to demonstrate the free disposability of the equity capital to be converted and which audit documentation must be filed with the commercial register office. While the existing practice is confirmed for financial statements subject to an ordinary audit, the EHRA requires additional audit procedures in the case of a limited audit or an opting-out.

In practice, this means carefully documenting the free disposability of the equity and involving the auditor in the preparation of the transaction at an early stage.

The audit firm or a licensed auditor should therefore be involved at an early stage in the preparation of the capital increase. If the required statement is missing or the auditor's confirmation does not meet the requirements, objections from the cantonal commercial register office are to be expected.

From a tax perspective, the equity positions to be converted must be selected carefully: whilst converting retained earnings reserves has withholding tax, income tax and issuance stamp duty consequences, these can largely be avoided by drawing instead on existing capital contribution reserves. Early tax analysis, together with clean documentation and reporting of capital contribution reserves, is therefore advisable.

AUTHORS

Thomas Stoltz

Partner

thomas.stoltz@baerkarrer.ch

T: +41 58 261 59 32

Susanne Schreiber

Partner

susanne.schreiber@baerkarrer.ch

T: +41 58 261 52 12

Julia Eiholzer

Senior Associate

julia.eiholzer@baerkarrer.ch

T: +41 58 261 59 36