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The concept of costs justified by commercial practice

Introduction

Swiss tax law provides that legal entities may deduct from their taxable profits expenses that are commercially justified (Art. 58 para 1 lit. b and 59 FTA). The law sets out, by way of example, certain expenses that are deemed to be commercially justified. The concept is therefore an indeterminate legal concept, the scope of which is not always easy to delineate. In this TaxPage, we explain how the concept has been defined in case law and highlight several aspects that may prove problematic.

Definition

The Federal Court has repeatedly ruled that business expenses are those that are directly related to the profit-making activities of a company. Any expenditure that can reasonably be regarded as part of a company's overheads must be recognised as a business expense. Whether the company could have avoided the expenditure in question or whether it is compatible with rational, profit-maximising business management is irrelevant. In the opinion of the Federal Court, it is not the task of the tax authorities to review the appropriateness of an expense. The economic justification of an expense must be assessed considering the specific circumstances of the individual case. Whether the expense was necessary for the company is not decisive; it is sufficient that there is an objective causal link between the expense and the economic purpose of the company. Such a connection exists if the expenditure would also have been made by a conscientious manager who fulfils the duty of care required under commercial law (SFC 9C_513/2025, consid. 5.1).

Issues and burden of proof

Where the tax authorities question the commercial justification of certain expenses, these often concern representation expenses (i.e. the acquisition of new customers or the maintenance of existing business relationships). Such expenses are generally disallowed where the shareholder is active in the company and personally attends the relevant events, on the grounds that the costs are primarily of private nature (living expenses or hobbies). In this context, the Federal Supreme Court recently ruled on a case involving an asset management company that had repeatedly organised hunting trips abroad. The company's shareholder participated in these trips together with clients, prospective clients and business partners. The Federal Supreme Court held that the company was required to demonstrate the commercial justification of these expenses. As the company was unable to demonstrate convincingly a link between the expenses — which accounted for more than 50% of the company's profits — and the

conclusion of new contracts, the Court found that the burden of proof had not been discharged. It therefore concluded that the expenses primarily served to finance the shareholder's personal passion and were not commercially justified. Accordingly, it upheld the lower court's decision denying the deduction of the costs. Unfortunately, the Federal Court often adopts a strict approach when assessing representation expenses. By their very nature, representation costs cannot be determined in advance, nor can the effectiveness of each expense in generating revenue. In the present case, it is questionable whether the tax authorities would have reached a different conclusion had turnover increased significantly during the relevant period. In practice, it is not uncommon for shareholders to play a central role in client relationships, giving rise to corresponding expenses.

Consequences

Expenses that are not considered as commercially justified are added back to the taxable profit. In addition, the company may be fined for (attempted) tax evasion. If the expenditure qualifies as monetary benefit to the shareholder, withholding tax, income tax and eventually penalties may be imposed. In most cases, the shareholder will also be denied a refund of the withholding tax, resulting in a significant tax burden.

Conclusion

It is recommended that all marketing and customer relationship expenses are properly documented and that their business purpose is objectively verifiable, which is not always easy. This is particularly true when the shareholder actively involved in the company, personally participating in or organising events aimed at retaining existing customers or attracting new ones.

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

valfor TaxTeam

Daniel Gatenby

daniel.gatenby@valfor.ch

Regina Schlup Guignard

regina.schlup@valfor.ch