Cross-border Dividends from the Perspective of Switzerland as the Source State – Selected Issues under Article 15 of the Swiss-EU Savings Agreement

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1. Introduction

The Swiss-EU Savings Agreement entered into force on 1 July 2005.[1] In essence, the Agreement, which complements the EU Savings Directive,[2] introduces rules regarding the retention on interest paid by 'Swiss paying agents' to individuals residing in the EU.

Article 15 of the Agreement, however, also deals with dividends, interest and royalty payments between companies. This provision, which is materially and systematically completely unrelated to savings taxation, was introduced in the Agreement at the request of Switzerland. As we shall see, it is designed to introduce between this country and EU Member States rules partially comparable to those embodied in the Parent-Subsidiary Directive[3] and Interest-Royalty Directive.[4] Indeed, according to Art. 15(1) and (2), cross-border dividends, interest and royalty payments between EU and Swiss companies[5] are, under certain conditions, no longer subject to any withholding tax. As from 1 July 2005, therefore, Art. 15 supersedes double taxation conventions (DTCs) concluded by Switzerland and EU Member States, to the extent these agreements are less favourable. From a procedural point of view, the benefit of Art. 15(1) may, upon request, be granted upfront by having the Swiss distributing company simply declaring ('*procédure de declaration*', '*Meldeverfahren*') the dividends to the Swiss Federal Tax Administration (FTA).[6]

The present contribution places Switzerland in the position of the state of source and discusses the scope and requirements of Art. 15(1) in the context of dividends paid by Swiss subsidiaries to their EU parent companies. After a presentation of the principles governing the treatment of dividends for Swiss withholding tax purposes, we begin by analysing the text of Art. 15(1) as well as the interpretative issues connected to this provision. We then move to the specific conditions of Art. 15(1) and shall, in this context, also critically review the administrative guidelines issues by the FTA thereupon on 15 July 2005.[7] On the other hand, we shall here leave aside Art. 15(2). Indeed, Switzerland currently not levying any withholding tax on royalties and interest paid on loans[8] granted to Swiss companies, the impact of this provision is limited in practice.

2. Outbound dividends under Swiss withholding tax

Switzerland levies *inter alia* a 35 per cent withholding tax on distributions of profits made by Swiss[9]

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1 Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments. For a general discussion of the Agreement see in particular Xavier Oberson, 'Agreement between Switzerland and the European Union on the Taxation of Savings – A balanced "*Compromis Helvétique*" ', in *IBFD Bulletin* 2005, no. 3, p. 108.

2 Council Directive 2003/48 of 3 June 2003 on taxation of savings income in the form of interest payments.

3 Council Directive of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (90/435/EEC) as amended by various Council Directives pursuant to the accession of new Member States, and by Council Directive 2003/123/EC of 22 December 2003.

4 Council Directive of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associates companies of different Member States (2003/49/EC).

5 Including their permanent establishments with respect to interest and royalty payments, see Art. 15(2).

6 This possibility is based on a Federal Ordinance of 22 December 2004 (RS 672.203) which also applies in a treaty context and for qualifying participations. Under this ordinance, the refund procedure is replaced by a declaration procedure. With respect to Art. 15(1), the benefit of this procedure must be requested to the FTA by the distributing company before the dividends fall due. This request must be made by using so-called 'Form 823C' (see *http://www.estv.admin.ch/data/dvs/druck/forms/forms/823Ce.pdf*). If the request is granted, the distributing company then simply declares the dividend free of any withholding tax by using so-called 'Form 108'. A refund procedure, however, is exceptionally applicable in cases in which a dividend is distributed before the two years holding requirement has elapsed (see n. 7 below).

7 *Directives relatives à la suppression de l'impôt anticipé suisse sur les paiements de dividendes entre sociétés de capitaux associées dans les relations entre la Suisse et les Etats membres de l'Union européenne/Wegleitung betreffend die Aufhebung der schweizerischen Verrechnungssteuer auf Dividendenzahlungen zwischen verbundenen Kapitalgesellschaften im Verhältnis zwischen der Schweiz und den Mitgliedstaaten der Europäischen Union* (hereafter FTA Guidelines (Art. 15)).

8 A withholding tax is indeed only levied on interest stemming from bonds (and similar negotiable debt instruments) as well as on interest on deposits with Swiss banks.

9 For withholding tax purposes, a 'Swiss company' is a company whose statutory seat is in Switzerland or a company incorporated abroad but which is effectively managed from within Switzerland and exercises an activity therein, see Art. 9, para. 1 of the Swiss Federal Withholding Tax Law of 13 October 1965, RS 642.21 (WHTL).

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companies.[10] As a rule, the tax claim arises when the income falls due,[11] the tax must be withheld by the distributing company and paid to the FTA.[12]

The concept of taxable distribution of profit for withholding tax purposes is fairly broad and is construed according to a substance over form approach ('*interprétation selon la réalité économique*'; '*wirtschaftliche Betrachtungsweise*'). In essence, it covers any payment made by a Swiss company to its shareholder or to a related party which does not constitute a reimbursement of the company's nominal capital (nominal value principle).[13] The taxable basis may therefore consist of both opened and hidden reserves. For example, distributions subject to withholding tax typically include cash and stock dividends, hidden profit distributions (including interest paid on constructive equity), total and partial liquidating distributions. Moreover, certain emigrations transactions also entail a deemed liquidation. Specifically, the transfer of a company's seat outside of Switzerland,[14] or an emigration merger, is assimilated to a liquidating distribution (liquidation fiction).[15]

Unless an international agreement provides otherwise, non-residents may not claim an exemption from or the reimbursement of the withholding tax levied on distributions of profits made to them.[16] For these persons, the Swiss withholding tax thus pursues, as a matter of principle, a fiscal function ('*Fiskalzweck*').

By contrast, residents of Switzerland, in particular companies having their statutory seat in this country[17] are, under certain conditions, entitled to a full reimbursement of the Swiss withholding tax. That is, they must first of all report the distribution of profit for direct tax purposes.[18] Secondly, according to Art. 21(1), lit a of WHTL, these persons must be the beneficial owners ('*droit de jouissance*'; '*Recht zur Nutzung*') of the income received. Finally, Art. 21(2) of WHTL stipulates that the reimbursement of the withholding tax is subject to the absence of tax avoidance by abuse law.[19] For Swiss residents satisfying these conditions, therefore, the Swiss withholding tax is primarily aiming at ensuring compliance with direct tax reporting requirements ('*Sicherungszweck*'). As we shall see, although they govern the reimbursement of the Swiss withholding tax in a purely domestic context, these provisions may also come into play in the context of an abusive application of Art. 15(1).

3. Article 15(1) and interpretative issues

Article 15(1) provides that:

> 'Without prejudice to the application of domestic or agreement-based provisions for the prevention of fraud or abuse in Switzerland and in Member States, dividends paid by subsidiary companies to parent companies shall not be subject to taxation in the source State where:
> – The parent company has a direct minimum holding of 25 per cent of the capital of such a subsidiary for at least two years, and,
> – One company is resident for tax purposes in a Member State and the other company is resident for tax purposes in Switzerland, and,
> – Under any double tax agreements with any third States neither company is resident for tax purposes in that third State, and,
> – Both companies are subject to corporation tax without being exempted and both adopt the form of a limited company.'

However, Estonia may, for as long as it charges income tax on distributed profits without taxing undistributed profits, and at the latest until 31 December 2008, continue to apply that tax to profits distributed by Estonian subsidiary companies to their parent companies established in Switzerland.

Finally according to Art. 15(3):

> 'Existing double taxation agreements between Switzerland and the Member States which provide for a more favourable taxation treatment of dividends ... at the time of adoption of this Agreement shall remain unaffected.'

As can be seen, there are several textual similarities between Art. 15(1) and the Parent-Subsidiary Directive. To begin with, the reference to 'domestic or agreement based provisions' is clearly inspired from Art. 1(2) of the

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10 Art. 4(1), lit b of WHTL.

11 Art. 12 of WHTL.

12 Art. 10 of WHTL. Specifically, according to Art. 14(1) of WHTL the debtor is under the obligation to transfer the tax liability to the creditor by deducting the amount of the withholding tax.

13 Art. 20 (1) of the Swiss Federal Withholding Tax Ordinance, RS 642.211 (WHTO).

14 See for example Peter Brülisauer, 'Sitzverlegung ins Ausland nach Verrechnungssteuerrecht', in FStR 2004, p. 48; Thomas Müller, 'Die solidarische Mithaftung bei der Sitzverlegung ins Ausland', in StR 2000, p. 78. This liquidation fiction applies even if a permanent establishment is maintained in Switzerland after the restructuring since, in such case, the company is no longer 'Swiss' within the meaning of Art. 9 of WHTL and therefore the withholding tax claim is not preserved.

15 Art. 4(2) of WHTL.

16 Subject however to certain exceptions, see Art. 24(3) and 4, Arts. 27 and 28 of WHTL.

17 Art. 24(2) of WHTL.

18 Art. 23 of WHTL.

19 In addition, the reimbursement must be requested within three years following the one in which the income arose (Art. 32(1) of WHTL).

Directive. Further, the reference to domestic and treaty law for the purpose of determining fiscal residence as well as the requirement that a company be 'subject to corporation tax without being exempted' are in line with Art. 2(1)(b) and (c) of the Directive. At the same time, however, the text of both instruments is not identical. For example, Art. 15(1) refers to 'dividends' while the Parent-Subsidiary Directive uses the expression 'distribution of profits'.[20] Similarly, Art. 15(1) requires a direct shareholding of 25 per cent whereas under the Directive this threshold is gradually reduced to 10 per cent as a result of its 2003 amendment. Finally, the scope of Art. 15(1) does not fully coincide with that of the Parent-Subsidiary Directive. First of all, Art. 15(1) deals only with the state of source and the exemption from withholding tax. By contrast, it is not concerned with the elimination of economic double taxation by the state of residence of the parent company. Article 15(1) does therefore not contain a rule comparable to that laid down in Art. 4 of the Parent-Subsidiary Directive. Secondly, while, as a result in particular of the recent case law of the ECJ,[21] permanent establishments are included in the Parent-Subsidiary Directive since its 2003 amendment,[22] the latter, by contrast, are out of the scope of Art. 15(1).

In light of the foregoing, an important issue which must thus be settled in relation to Art. 15(1) is whether, and if so to what extent, the Parent-Subsidiary Directive can be said to be relevant in the context of the interpretation of this provision. As a starting point, it should be borne in mind that Art. 15(1) forms part of an international Agreement. It is therefore subject to the interpretative provisions (Arts. 31 to 32) of the Vienna Convention on the Law of Treaties[23] (VC).[24] Moreover, the Agreement not containing a *lex specialis* comparable to Art. 3(2) of the OECD MC providing for a reference to domestic law,[25] the interpretation of its terms is, in our view, solely governed by the rules of the VC.

Accordingly, the interpretation of Art. 15 should begin by considering the ordinary meaning of its terms.[26] If appropriate, however, the teleological interpretation[27] should also refine this textual analysis. In our opinion, the influence that the Parent-Subsidiary Directive may have in this area is precisely of a teleological nature. Indeed, as indicated, the context in which the Agreement was adopted clearly reveals that the purpose of Art. 15 is to partially extend the regime embodied in the Parent-Subsidiary and the Interest-Royalties Directives to Switzerland. For example, the Council decision of 2 June 2004 on the signing and conclusion of the Agreement states:

> 'the Community has decided to grant the request of the Swiss Confederation for the inclusion in the Agreement of measures equivalent to the regimes provided for in Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States and in Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States in their original versions.'

Therefore, in our opinion, an interpretation of Art. 15 on the basis of its object and purpose should, where appropriate, take into consideration the provisions of the Parent-Subsidiary Directive as construed by the case law of the ECJ[28] and leading scholarly opinion. As a matter of fact, this line of reasoning is not new in Switzerland. Indeed, in a decision of 28 February 2001[29] involving Art. 10 (dividends) of the Switzerland-Luxembourg DTC, the Swiss Federal Appeal Commission for Tax Matters observed that the purpose of this provision was essentially to introduce, between the Contracting States, rules similar to those contained in the Parent-Subsidiary Directive. The Court consequently arrived at the conclusion that a contextual interpretation of this provision could not ignore this instrument.

4. Payment of dividends

With respect to the payment of dividends, several issues need to be clarified. First of all, the meaning of the term 'dividends' used by the Agreement must be

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20 Art. 1.

21 See in particular *Compagnie de Saint-Gobain v Finanzamt Aachen-Innenstadt*, C-307/97, ECJ.

22 See thereupon Guglielmo Maisto, 'The 2003 amendments to the EC Parent-Subsidiary Directive: what's next?', *EC Tax Review* 2004, no. 4, p. 177.

23 Vienna Convention of 23 May 1969 on The Law of Treaties (RS 0.111).

24 Oberson, see n. 1 above, p. 109; Howard R Hull, 'The EC Parent-Subsidiary Directive in Switzerland – Swiss Outbound Dividends', in *IBFD Bulletin* 2005, p. 69.

25 Rather, the Agreement simply provides for a consultation procedure designed to resolve interpretative issues through a mutual agreement (see Art. 12 of the Agreement).

26 Art. 31(1) *ab initio* VC, Swiss Federal Tribunal Judgment of 17 February 1971, ATF 97 I 364; Jean-Marc Rivier, 'L'interprétation des Conventions de double imposition', in *Revue de Droit Administratif et de Droit Fiscal* (RDAF) (Lausanne, Switzerland, 2000), p. 113; Xavier Oberson, *Précis de droit fiscal international*, 2nd ed. (Bern, 2004), p. 25, no. 80; Peter Locher, *Einführung in das internationale Steurrecht der Schweiz*, 3rd ed. (Bern, 2005), p. 117; Ekkehart Reimer, 'Interpretation of Tax Treaties', in *European Taxation* 1999, pp. 462–464; Stanley Katz, 'Interpretation of Double Taxation Conventions (US national report)', in *Cahier de Droit Fiscal International* (The Hague, 1993), vol. LXXVIIIa, p. 629.

27 Art. 31(1) *in fine* VC.

28 In the same vein Hull, see n. 24 above, p. 70.

29 StR 2002 30, 37.

identified. Secondly, the temporal scope of Art. 15(1) needs to be ascertained. Finally, as Art. 15(1) refers to dividends paid 'to' parent companies, it is submitted that the benefits of this provision are subject to a 'personal attribution of income requirement' the meaning of which must be clarified in the specific context of the Agreement.

A. The concept of 'dividends paid'

1. Under the Agreement

Article 15(1) refers to 'dividends' but does not provide for a definition of this term. In its guidelines the FTA contends that this term should be defined in light of Art. 10(3) of the OECD MC.[30] The first sentence of this provision defines the term 'dividends' autonomously by stipulating that it means: 'income from shares, "*jouissance*" shares or "*jouissance*" rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits . . .'. This autonomous definition is however complemented by a general reference to the domestic law of the state of source: 'as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident'.

As we shall see, the conclusion at which the FTA arrives on the basis of this interpretation is essentially correct. Yet, we submit that referring to Art. 10 of the OECD MC to define the notion of 'dividends' used by Art. 15 is methodologically erroneous. First of all, there is no reference to the OECD MC in Art. 15. Further, there is no indication whatsoever of an intention of Switzerland and the EU Member States to rely on the OECD MC. Secondly, there is an essential structural difference between Art. 15 and Art. 10(3) of the OECD MC. Indeed, contrary to Art. 10(3) of the OECD MC, Art. 15 does not contain a general reference to the domestic law of the state of source. Moreover, as mentioned, such reference is generally not possible under the Agreement in the absence of a provision comparable to Art. 3(2) of the OECD MC. The structure of Art. 10(3) of the OECD MC is thus different from that of Art. 15 which requires the term 'dividends' to be defined autonomously.

In our opinion, the concept of 'dividends' incorporated in Art. 15(1) should rather be construed in light of the Parent-Subsidiary Directive. It is certainly true that this conclusion may at first sight be challenged on the ground that the Directive does not refer to 'dividends' but instead to 'distribution of profits'. On the basis of a strict literal interpretation it could thus be argued that, by referring to 'dividends' rather than to 'distribution of profits', Art. 15 is meant to be narrower than the Parent-Subsidiary Directive. This being said, in our opinion, the interpretative process reveals that the term 'dividends' used by Art. 15 has the same meaning than the expression 'distribution of profits' under the Parent-Subsidiary Directive. First of all, Art. 15(1) contains a reservation in favour of Estonia as regards payments by Estonian subsidiaries companies to their parent companies in Switzerland. This reservation, which is designed to take into account that under Estonian law undistributed profits are not subject to tax, stipulates that 'profits distributed' by Estonian companies do not fall within the scope of Art. 15 until 31 December 2008 at the latest.[31] Absent such a reservation, Art. 15 would thus have been applicable to 'profits distributed' by an Estonian company. The use by this reservation of the term 'profits distributed', which is identical to the expression 'distribution of profits', therefore suggests an interpretation in light of the Parent-Subsidiary Directive. Secondly, Art. 15 and the Parent-Subsidiary Directive are structurally similar in that they do not contain any definition in this area nor any reference to domestic law. The expressions 'dividends' and 'distributions of profits' used respectively by Art. 15 and the Parent-Subsidiary Directive must both be given an autonomous meaning and are consequently of the same nature.[32] Finally, the objective of Art. 15 is clearly partially to introduce between Switzerland and the EU Member States benefits which are analogous to those embodied in the Parent-Subsidiary Directive. While the scope of Art. 15 and some of its conditions do not fully coincide with those of the Parent-Subsidiary Directive, it is submitted that this objective may only be achieved if a payment that qualifies as a distribution of profits under the Directive falls within the scope of Art. 15 when it is made to a Swiss parent company. The teleological interpretation consequently also confirms this conclusion.

In light of the foregoing, we shall now try to define the meaning of a 'distribution of profits' under the Parent-Subsidiary Directive and determine whether, and if so, to what extent, a definition of the concept of 'dividends' pursuant to this meaning would differ from the interpretation of the FTA based on Art. 10(3) of the OECD MC. As a starting point, it can be observed that the expression 'distribution of profits', which is to be construed substantively,[33] is fairly broad and is designed to apply not only to payments that are

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30 FTA Guidelines (Art. 15), s. 3.

31 This reservation, on the other hand, does not apply to distributions made by a Swiss company to its Estonian parent company, FTA Guidelines (Art. 15, s. 2b).

32 For the Parent-Subsidiary Directive see Ben Terra and Peter Wattel, *European Tax Law*, 4th ed. (Kluwer, 2005), 514–515; Marjanna Helminen, *The Dividend Concept in International Tax Law* (Kluwer, 2000), p. 73; Marjanna Helminen, 'Dividend equivalent benefits and the concept of profit distribution of the EC Parent-Subsidiary Directive', in *EC Tax Review* 2000, p. 162.

33 Terra and Wattel, see n. 32 above, p. 514.

formally labelled as 'dividends'.[34] Rather, a distribution of profits covers any kind of transfer of benefit from a qualifying subsidiary to another qualifying parent company for no equivalent value or benefit in exchange.[35] Further, it is immaterial, for this purpose, whether the dividend is financed by current profits, opened or hidden reserves.

Based on this broad definition, it is possible to contend that the exemption laid down in Art. 5 of the Parent-Subsidiary Directive applies to both cash and stock dividends (bonus shares). Similarly, this exemption is also applicable to liquidating distributions.[36] Secondly, a substance over form approach being relevant in this area, the expression also covers hidden profits distributions[37] (constructive dividends) made by a subsidiary.[38] Among these payments are also interest payments reclassified as a hidden profit distribution pursuant to thin capitalization rules applied at the level of the subsidiary. Moreover, as we shall see, a constructive equity should be regarded as 'capital' for the purpose of calculating the holding of the parent company in the subsidiary.[39]

It is undisputed that these profit distributions also qualify as 'dividends' under Art. 10(3) of the OECD MC.[40] In this area, therefore, it is fair to say that the interpretation suggested by the FTA leads to the same conclusion as that we are advocating.[41]

Another question, however, which is not discussed by the FTA in its guidelines, is whether purely 'fictive distributions' are also covered by Art. 15. In essence, a fictive distribution is an operation that is fiscally treated as a distribution of profits but which, from a private law or even economic point of view, does not lead to any transfer of benefit to the company's shareholders. From the perspective of the state of residence a well-known example, which has been discussed in the context of the Parent-Subsidiary Directive, is distributions that a parent company is deemed to derive in accordance with a CFC legislation.[42] On the other hand, for Switzerland and when this country is placed in the position of the state of source, with which Art. 15 is solely concerned, fictive distributions, as we have seen, typically come into play in the case of certain emigration transactions (cross-border transfer of seat, merger or division etc.) which, for withholding tax purposes, are assimilated to a liquidation of the Swiss company.

Whether a fictive distribution falls within the scope of Art. 10(3) of the OECD MC is debated among scholars and is not clearly settled by the OECD Commentary.[43] It may certainly be argued that by referring to the tax treatment in the state of source, the second sentence of Art. 10(3) of the OECD MC also includes a fictive distribution where such distribution is fiscally classified as 'income from shares' in that state. However, such distribution must also be 'paid' within the meaning of Art. 10(1) of the OECD MC. According to the OECD Commentary the term 'paid' has a very wide meaning but it is characterized by the fact that funds are put at the disposal of the shareholder.[44] In other words, the term 'paid' implies a real shift of assets or value from one taxpayer to another.[45] For this reason, it has been argued that fictitious income does not fall under Art. 10 of the OECD MC.[46] Relying on the fact that this expression should be defined *lege fori* in accordance with Art. 3(2) of the OECD MC, other commentators, on the contrary, have arrived at the conclusion that a fictive distribution should be regarded as being 'paid' if the state of source treats it as such.[47]

This being said, in our opinion, this latter reasoning may at any rate not be transposed to Art. 15 which, in the absence of a comparable rule, requires the term

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[34] See Susan Bell, 'Cross-Border Repatriation of Dividends', in IBFD *Derivatives & Financial Instruments journal* (DFI) 2005, p. 18; Maisto, see n. 22 above, p. 177; Helminen, n. 32 above, 2000a, p. 74; Helminen, 2000b, n. 32 above, p. 162.

[35] Helminen, 2000b, n. 32 above, p. 162; Helminen 2000a, n. 32 above, p. 74. Similarly, Terra and Wattel, see n. 32 above, p. 514 define a distribution of profits as 'any value shift to the parent company at the expense of the capital of the subsidiary...'.

[36] See Bell, n. 34 above, p. 25; Terra and Wattel, see n. 32 above, p. 515; Helminen, see n. 32 above, 2000b, p. 171; Helminen 2000a, n. 32 above, p. 356. Under the Parent-Subsidiary Directive, this conclusion is based on a systematic interpretation. That is, it has been argued that because liquidating distributions are expressly excluded under Art. 4 ('.except when the subsidiary is liquidated'), the conclusion may be drawn *a contrario* that such payments are covered by Art. 5 (see for example Helminen 2000b, n. 32 above, p. 171).

[37] As regards the issue of hidden profit distributions made between related companies, see 4.C. of this article.

[38] Helminen, 2000a, n. 32 above, p. 236; Terra and Wattel, n. 32 above, p. 515. See also the opinion of Advocate General Mischo of 26 September 2002 in C-324/00 (*Lankhorst-Hohorst GmbH v Finanzamt Seinfurt*) decided by the ECJ on 12 December 2002. In this opinion, the Advocate General, endorsing the view expressed by Denmark, considered that a *covert* distribution should, under the Parent-Subsidiary Directive, receive the same treatment than an *overt* distribution.

[39] See section 6 of this article.

[40] See in particular OECD Commentary paras. 15 and 28 and Art. 10 of the OECD MC.

[41] See FTA Guidelines (Art. 15, ss. 3 and 4).

[42] See for example recently Marjaana Helminen, 'Is There a Future for CFC Regimes in Europe?', in *Intertax* 2005, p. 118. The compatibility of CFC legislations with EU law is currently at stake further to the *Cadbury Schweppes* case (C-196/04) pending before the ECJ.

[43] See OECD Commentary, para. 38 and Art. 10 of the OECD MC.

[44] OECD Commentary, para. 7 and Art. 10 of the OECD MC.

[45] Peter Wattel and Otto Marres, 'Characterization of Fictitious Income under OECD-Patterned Tax Treaties', in *European Taxation* 2003, p. 68.

[46] Wattel and Marres, *ibid*., p. 74.

[47] Helminen, 2000a , n. 32 above, p. 214.

'paid' to be defined autonomously in accordance with the rules of the VC. Accordingly, the issue that must be settled is whether this autonomous meaning also encompasses fictive distributions. It is submitted that an interpretation of the term 'paid' in light of the object and purpose of Art. 15 dictates an affirmative answer. Indeed, the leading interpretation of the Parent-Subsidiary Directive is that if, from a fiscal point of view, a state assimilates a particular operation to a distribution, such operation then becomes a 'distribution of profits'.[48] Further, a justification for the eligibility of fictive distributions to the benefits of the Parent-Subsidiary Directive may also be found in the fact that the purpose of this instrument is to encourage and facilitate the setting up of cross-border enterprises.[49] A teleological interpretation of the term 'paid' on the basis Parent-Subsidiary Directive consequently reveals that Art. 15 also applies to fictive distributions.

We therefore arrive at the conclusion that the expression 'dividends' embodied in Art. 15, which should be construed in accordance with a substance over form approach, refers to any transfer of benefit that is made by a company to its shareholder (or related party) for no equivalent benefit, whether stemming from current profits, opened or hidden reserves. It covers in particular the following:

- Ordinary dividend distributions (whether in cash or in kind).
- Payment stemming from a partial or total liquidation of the subsidiary (liquidating distributions).
- Hidden profit distributions, including interest payments reclassified as constructive dividends under thin capitalization rules.
- Payments or transactions (whether actual or fictive) classified as or assimilated to a distribution of profits under the laws of the state of source.

This definition is very much in line with that favoured by the FTA which relies on the definition contained in Art. 10(3) of the OECD MC. As shown above, it is by contrast controversial whether a fictive distribution falls within the scope of this provision. On the other hand, an interpretation based on the Parent-Subsidiary Directive, such as that we are advocating, entails that fictive distributions should indeed be covered by Art. 15.

Having identified the meaning of the expression 'dividends paid' under Art. 15, let us now examine the impact of this provision on Swiss domestic (withholding) tax law.

2. Impact under Swiss domestic (withholding) tax law

In our opinion, the concept of 'dividends' contained in Art. 15 is sufficiently broad to cover all distributions of profits that are subject to Swiss domestic withholding tax. First of all, it is possible to characterize as 'dividend' any transfer of benefit that is made by a company to its shareholder or related party for no equivalent benefit. This definition therefore very much coincides with the Swiss withholding tax concept of distribution of profit which, as we have seen, is also to be construed in accordance with a substance over form approach. Further, relying on a teleological interpretation of Art. 15, we concluded that fictive distributions should also be covered by this provision. Therefore, in our opinion, a liquidation fiction stemming from a cross-border restructuring (transfer of seat, merger) is covered by Art. 15.

B. Temporal scope of Article 15 and 'compartimentalization' of dividends

Another question which must be settled with respect to Art. 15 is the material time at which the conditions of this provision must be met. In other words, as for DTCs, the temporal scope ('*Schrankenwirkung*')[50] of Art. 15 must be identified.

In our opinion the term 'paid' used by Art. 15 (as well as by Art. 10(1) of the OECD MC), indicates that the conditions laid down by this provision are to be satisfied at the time the dividends falls due.[51] Therefore, for example, Art. 15 will not be applicable if, upon the payment of a dividend, the Swiss subsidiary is no longer owned by a Belgian parent company but, say, by a US corporation. It is immaterial for this purpose that this dividend is in fact paid out of profits generated during the time the Swiss subsidiary was controlled by a Belgian company. By mirrored reasoning, Art. 15 should apply in the reverse case, that is where a dividend is financed by profits realized at a time at which the requirements of this provision were not met. Indeed, unlike certain treaty provisions,[52] Art. 15 (and Art. 10(1) of the OECD MC) is not concerned with the origin or cause of the payment ('*Kausalitätsprinzip*') but focuses on the contrary exclusively on the time at which this payment is made ('*Zuflus-*

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48 Bell, see n. 34 above, p. 25; Helminen, 2000b, n. 32 above, p. 164; Helminen, 2000a, n. 32 above, p. 209. See also Cécile Brokelind, 'Ten years of application of the Parent-Subsidiary Directive', in *EC Tax Review* 2003, p. 161.

49 Claus Staringer in IFA, *Cross-Border Effects of Restructuring Including Change of Legal Form*, vol. 25d (IFA Congress Seminar series, Munich), (Kluwer, 2000), p. 85.

50 See Joseph Schuch, *Die Zeit im Recht der Doppelbesteuerungsabkommen* (Vienna, 2002), p. 151; Robert J. Danon. and Hugues Salome, 'De la double imposition internationale', in *Archives de droit fiscal Suisse 73* (2004/2005), p. 367.

51 Which is also recognized by the FTA; see FTA Guidelines (Art. 15, s. 11).

52 See for example Art. 15 of the OECD MC dealing with employment income.

sprinzip').[53]

A so-called 'compartimentalization' of dividends (based on the origin of the profits financing the distribution) is therefore not compatible with the ordinary meaning of the term 'paid' contained in Art. 15. The object and purpose of Art. 15 also supports this conclusion as this position is also the one defended under the Parent-Subsidiary Directive.[54] This being said, in the field of DTCs, the FTA generally relies on such a 'compartimentalization' of dividends which is known as the 'old reserves theory' ('*Alreservenpraxis*'). Broadly speaking, this practice entails that if a resident of State A, for example in the course of a restructuring, transfers a Swiss subsidiary to a resident of State B and that the Swiss State B DTC provides for more favourable conditions (typically a lower residual rate on dividends) than the Swiss-State A DTC, the distributable reserves existing at the time of the transfer will remain nonetheless subject to the Swiss-State A DTC. Accordingly, upon distribution of a dividend stemming from these old reserves, the Swiss withholding tax will be reduced in accordance with the Swiss-State A DTC, regardless of whether such dividend is actually 'paid' to a resident of State B.

Invoking in particular the temporal scope of Swiss treaty provisions patterned upon Art. 10(1) of the OECD MC, Swiss leading commentators have heavily criticized this 'old reserves theory'.[55] Despite these criticisms, however, the guidelines relating to Art. 15 clearly indicate that the FTA will continue to apply this theory in the context of this provision.[56] Accordingly, Art. 15 would not be applicable where, for example, a dividend is distributed to a Belgian parent company out of profits generated at a time at which the Swiss distributing subsidiary was a controlled by a US parent company.

In our opinion, the application of the 'old reserves theory' as a general rule, whether in the context of DTCs or Art. 15, is arbitrary and grossly ignores the temporal principles governing the payment of dividends. Rather, in our view, this theory may only come into play where an abusive application of Art. 15 is at stake On the contrary, there is no room for such a theory if, for instance in the context of a *bona fide* restructuring motivated by obvious business reasons, a Swiss participation is transferred to a European holding company. In this respect, whether or not a restructuring is abusive, should, in our view, be decided solely in light of the specific concept of abuse that is relevant in the context of Art. 15.[57]

C. Entitlement and personal attribution of income

1. Under the Agreement

The application of DTCs patterned upon the OECD MC presupposes a connection between the treaty favoured income (tax object) and a given taxpayer (tax subject).[58] In our opinion, this condition flows from the language of the distributive rules, which by using terms such as 'derived by',[59] 'profits of',[60] 'income of',[61] 'paid to',[62] clearly express a personal attribution of income requirement.[63] This being said, a definition of these terms *lege fori* pursuant to Art. 3(2) of the OECD MC may lead to double (or to double non-) taxation where the domestic attribution rules of both Contracting States are not identical ('conflicts of attribution'; '*Zurechnungskonflikte*'). In order to resolve these conflicts, which for example typically come into play in the field of partnerships, trusts and other hybrid vehicles,[64] we have argued that, in source-residence conflicts, these 'connecting terms' should receive a contextual meaning. Specifically, we have arrived at the conclusion that, in accordance with the general recommendation embodied in the OECD Partnership Report:[65]

'the State of source should take into account, as part of the factual context in which the Convention is to be applied, the way in which an item of income, arising in its jurisdiction, is treated in the jurisdiction of the

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53 In the field of DTCs see in particular Maja Bauer-Balmelli, 'Altreservenpraxis – ein rechtliches Argumentarium', in *IFF Forum* 2004, p. 205; Danon and Salome, n. 50 above, p. 367.

54 Terra and Wattel, see n. 32 above, p. 514.

55 Bauer-Balmelli, see n. 53 above, p. 201.

56 FTA Guidelines (Art. 15, s. 3). On the other hand, if the former shareholder resides in an EU state, Art. 15 would be applicable unless the DTC concluded by Switzerland with that state is more favourable

57 For the definition of *abuse* in the context of Art. 15, see later in this article.

58 Hugh J. Ault, 'Issues Related to the Identification and Characteristics of the Taxpayer', in *IBFD Bulletin* 2002, p. 263; Robert J. Danon and Hugues Salome, 'Avoidance of Double Non-Taxation in Switzerland (Swiss national report)' in (ed. Michael Lang), *Avoidance of Double Non-Taxation, Schriftenreihe zum Internationalen Steuerrecht* (Schulthess, Linde Verlag, 2003), p. 388; Robert J. Danon and Hugues Salome, 'La double non-imposition (Swiss national report)', in *Cahiers de droit fiscal international* (CDFI), vol. LXXXVIVa (Kluwer, 2004), p. 677.

59 Arts. 6(1); 15(1); 16(1) and 17(1) of the OECD MC.

60 Art. 7(1) of the OECD MC.

61 Art. 21, para. 1 of the OECD MC.

62 Arts. 10(1), 11(1), 18(1), 19(1) of the OECD MC.

63 Danon and Salome, see n. 58 above, p. 340.

64 See Robert J. Danon, *Switzerland's direct and international taxation of private express trusts* (Geneva, 2003), p. 296.

65 OECD, 'The Application of the OECD Model Convention to Partnerships', in *Issues in International Taxation Series* no. 6 (Paris, 1999).

person claiming the benefits of the Convention as a resident.'[66]

In other words, an item of income can be considered to be paid 'to' a resident of a Contracting State where, under the attribution rules of such state, this income is allocated to this person. As we have shown, this conclusion is, from a systematic point of view, supported by the relationship existing between the distributive rules and the principle of relative effect of DTCs which apply only 'to persons who are residents of one or more or both of the Contracting States'.[67] Accordingly, it seems logical to draw the conclusion that this principle implies that DTCs are only to produce their effects within the limits of the fiscal sovereignty of the Contracting States. In other words, the application of a DTC requires the item of income covered by the relevant distributive rule to enter into the taxing jurisdiction of the other Contracting State.[68] From this perspective, therefore, turning to the attribution rules of the state of residence to ascertain whether this is the case, is the most convincing solution.[69]

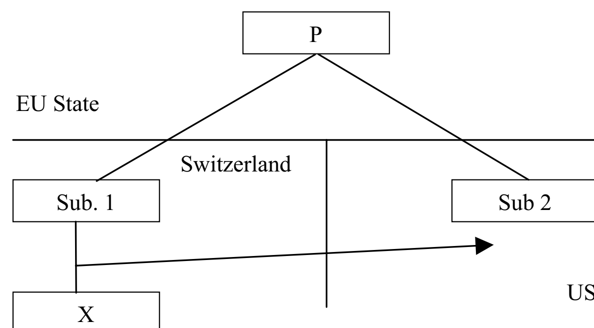
In our opinion, the same interpretation should prevail in the context of Art. 15. That is, where under the laws of the state of residence, a dividend is allocated to the parent company for tax purposes,[70] the state of source should, regardless of its own attribution rules, consider that such dividend is 'paid to' the parent company within the meaning of Art. 15. In fact, the need for such a contextual interpretation is even more apparent under Art. 15 which, as we have seen, does not contain a provision comparable to Art. 3(2) of the OECD MC. Further, by requiring that the dividend be allocated to the parent company in the residence state, this interpretation ensures that the relative effect of the Agreement be complied with.

2. Impact under Swiss domestic (withholding) tax law

Swiss withholding tax attribution principles are, as a matter of principle, rooted in the so-called 'direct beneficiary theory' ('*Direktbegünstigungstheorie*').[71] That is, for Swiss withholding tax purposes, the recipient of a distribution of profit is the person benefiting directly from this distribution. In other words, the party to whom a distribution of profit is attributed is not necessary the shareholder. The impact of this theory, as well as the differences existing between Switzerland and EU Member States in this area, essentially materialize in the field of hidden profit distributions made between group companies. Indeed, the 'direct beneficiary theory' entails that a hidden profit distribution made to a sister company is attributed to that company.[72] By contrast, under the 'triangular theory' adopted by several European jurisdictions, such distribution will be deemed to be paid to the common parent company which, in turn, will be considered as making a capital contribution to the group company[73] ('dividend up and contribution to capital down').[74]

As shown by the following example, such differences may lead to conflicts of attribution which may adversely affect the application of Art. 15. Suppose that P is a company resident in an EU Member State for domestic tax and treaty purposes. P wholly owns Sub. 1, a company resident in Switzerland for domestic tax and treaty purposes, and Sub. 2, a company resident in the US. In the context of a reorganization, Sub. 1 transfers its participation in company X at book value to its sister company, Sub. 2. Under the laws of the EU Member State the constructive dividend stemming from the transfer (difference between fair market value and book value of the participation) is deemed to be paid to P (triangular theory). For Swiss withholding tax purposes the transfer will equally be treated as a hidden profit distribution. However, in accordance with the 'direct beneficiary' theory, such distribution will, from a domestic tax perspective, be considered to be made to Sub. 2.

Relying on its own domestic attribution principles



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[66] This general recommendation has been included in the 2000 update of the OECD Commentary; see para. 6.3 and Art. 1of the OECD MC.

[67] Art. 1 of the OECD MC.

[68] Danon and Salome, 2003, n. 58 above, p. 402.

[69] Danon and Salome, 2003, n. 58 above, p. 402.

[70] Whether, on the contrary, the income allocated is in addition subject to tax or exempted (by virtue for example of a participation exemption) is irrelevant for this purpose.

[71] See for example Markus Reich, in: Zweifel and Athanas, *Kommentar zum Schweizerischen Steuerrecht II/2, Bundesgesetz über die Verrechnungssteuer* (Zurich, 2005), p. 435 and Art. 14. In some limited cases, however, the triangular theory ('*Dreieckstheorie*') is exceptionally applied, see FTA notice of February 2001 and thereupon, Maja Bauer-Balmelli, 'Änderung in der Anwendung von Dreicks- und Direktbegünstigtentheorie', in FStR 2001, p. 58.

[72] See in particular ASA 59 496, Stockar and Hochreutener (eds.), *Die Praxis der Bundessteuern, II. Teil: Stempelabgaben und Verrechnungssteuer*, Band 2, Basel, nos. 12 and 25 and VStG 14.

[73] See Helminen, 2000a, n. 32 above, p. 238.

[74] J. David B. Oliver, 'The Parent-Subsidiary Directive of 23 July 1990: A United Kingdom Perspective', in *EC Tax Review* 2001, no. 4, p. 217.

('direct beneficiary theory'), Switzerland could, in such case, argue that Art. 15 does not apply, the hidden profit not being made to P but rather to Sub 2, a company resident outside the EU and not owning Sub. 1 directly. By contrast, Art. 15 would have been applicable, had the attribution principles of Switzerland been identical to those of the EU state ('triangular approach'). In other words, it is solely domestic law which here would entail the non-application of Art. 15.

For the time being it seems that the FTA will continue to rely on the 'direct beneficiary theory'[75] and therefore probably not apply Art. 15 in the foregoing circumstances. In our opinion, however, the denial, by the state of source, of the benefits of Art. 15 on the mere ground of diverging domestic attribution principles, is not acceptable. Rather, as we have shown, this type of conflict of attribution should be resolved by construing the term 'paid to' in accordance with the laws of the state of residence.[76] Accordingly, the hidden profit distribution being made to P under the laws of the EU Member State, Switzerland, should, in this example, consider that this distribution is 'paid to' P (regardless of its own domestic attribution principles) and, therefore, that Art. 15 applies. It is interesting to observe that some commentators also favour such an autonomous analysis in the context of Art. 5 (exemption from withholding tax) of the Parent-Subsidiary Directive. For example, in the field of secondary transfer pricing adjustments made between sister companies, Maisto observes that domestic law qualifications should not influence the application of this provision. Therefore, for this author, the circumstance that the domestic law of the source state views the profit distributed directly to the sister company is immaterial.[77]

On the contrary, such conflicts of attribution are less likely to occur in the field of cross-border restructurings leading to a deemed liquidation for withholding tax purposes (transfer of seat, merger).[78] Indeed, in these instances, the assimilation to a liquidation entails that the fictive distribution is *lege fori* also considered to be made to shareholders (and not, for example, to the absorbing company in the case of a merger).[79]

5. Tax residence

Article 15(1) applies where 'one company is resident for tax purposes in a Member State and the other company is resident for tax purposes in Switzerland, and, under any double tax agreements with any third States neither company is resident for tax purposes in that third State . . .'. The language of Art. 15(1) is here clearly inspired from Art. 2(1)(b) of the Parent-Subsidiary Directive which requires that a company be regarded as a resident of a Member State for domestic tax purposes and, in addition, under any DTC concluded with a third state ('under the terms of a double taxation agreement concluded with a third State, is not considered to be resident for tax purposes outside the Community'). The purpose of Art. 2(1)(b) is to exclude from the scope of the Parent-Subsidiary Directive so-called 'dual-resident companies' which, for example, are incorporated in a Member State but which, in accordance with a DTC concluded with a non-EU state (typically on the basis of a tie-breaker rule patterned upon Art. 4(3) of the OECD MC), are considered to be resident in that state.[80] On the other hand, companies having their statutory seat and their effective management in different EU Member States are not disqualified.[81]

Under Arts. 15(1) and 2(1)(b) the issue of residency is thus examined by reference to domestic and treaty law. Accordingly where it is placed in the position of the state of source, Switzerland should proceed according to a 'two steps approach'. That is, it should, first of all, be determined whether the parent company of the Swiss distributing subsidiary qualifies as a resident under the domestic tax law of an EU Member State; in other words, whether the parent company is 'liable to tax' in a Member State within the meaning of Art. 4 of the OECD MC.[82] If this is the case, it should then be examined whether this conclusion is challenged by any DTC concluded by that state with a non-EU state.[83] Indeed, in the affirmative, Art. 15 would not be applicable. In essence, therefore, the main situations to be taken into consideration may be summarized by the following table.

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75 See for example FTA Circular of 1 June 2004 on restructurings, in particular p. 60, example 22(4).

76 The same conflict may also occur in a DTC context and should, in our opinion, be resolved in the same fashion, see Danon and Salome, n. 50 above, p. 352.

77 Maisto, see n. 22 above, p. 178. This author does not however suggest an interpretation on the basis of the attribution rules of the state of residence but rather simply that an autonomous analysis should prevail. Other commentators, by contrast, have considered this problem but have simply submitted that Art. 5 and Art. 4 of the Parent-Subsidiary Directive should apply if the state of source, respectively the state of residence considers that the distribution is deemed to be made to the parent, see Oliver, n. 74 above, p. 217, Helminen, 2000a, n. 32 above, p. 238. These commentators have however not considered the case in which the states involved have diverging attribution principles (conflict of attribution).

78 See above 3.A.2.

79 See Reich, n. 71 above, pp. 436–437, no. 29 and Art. 14.

80 Terra and Wattel, n. 32 above, p. 495.

81 *Ibid*., p. 339.

82 FTA Guidelines (Art. 15, s. 6).

83 See FTA Guidelines (Art. 15, s. 7).

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	OECD-DTC ('tie-breaker rule based on effective place of management') with non-EU Member State	No DTC with non-EU Member State
Effective management in an EU Member State and incorporation in a non-EU Member State	Application of Art. 15 (residence in EU Member State)	Application of Art. 15 (residence in EU Member State)
Incorporation in an EU Member State and effective place of management in a non-EU Member State	No application of Art. 15 (residence in third State)	Application of Art. 15 (residence in EU Member State)

6. Minimum holding level

Article 15(1) provides that both companies adopt the form of a limited company. For Switzerland, as mentioned in the Agreement itself, only three forms of companies are mentioned[84] despite the fact that other types of corporate entities can be concerned by Swiss withholding tax (e.g. the *Genossenschaften* – société coopératives).[85] The Agreement, however, does not provide for a list of qualifying companies in the Member States. Considering the close relationship with the Parent-Subsidiary Directive, it seems appropriate to refer to the list enclosed to the Directive.[86]

The Agreement requires a *direct* holding in the company making the distribution. This first means that the 25 per cent threshold has to be directly outstanding between the paying and the receiving company. This being said, according to the FTA Guidelines, a parent company is deemed to own its Swiss subsidiary directly if a partnership is interposed between the two companies but that, under the laws of the state of residence of the parent, this partnership is treated as fiscally transparent. This approach, which has been advocated by leading commentators,[87] is in accordance with the general recommendation of the OECD Partnership Report.[88] The parent can however not claim the benefits of Art. 15 if it holds less than a 25 per cent-interest, even if, indirectly, both companies belong to the same parent company indirectly holding at least the 25 per cent threshold.[89]

The direct holding requirement may also be problematic where, for example, a constructive dividend is made to a group company (other than the parent). Indeed, as we have seen, Switzerland could, by relying on its domestic attribution principles (direct beneficiary theory) argue that Art. 15 does not apply on the ground that this distribution is not made to a company having a direct 25 per cent holding in the Swiss subsidiary. In our opinion and for the reasons exposed above,[90] however, the constructive dividend should for the purpose of the Agreement be deemed to be 'paid to' the parent company if, under the laws of the state of residence, such distribution is allocated to the parent company for tax purposes (triangular theory). Indeed, in these instances, such an autonomous interpretation of the term 'paid to', avoids a source-residence conflict of attribution.

Finally, Art. 3(2) of the Parent-Subsidiary Directive allows the Member States to replace the criterion of percentage in the capital of the subsidiary by the criteria of the voting rights. This option does not exist in Art. 15 of the Agreement. Consequently, the voting rights are irrelevant as far as the application of the Agreement is concerned. This focus on the economical rights corresponds to the Swiss domestic rules applied in several circumstances, where the percentage of interest in a subsidiary is meaningful.[91] The reference to the 'capital' of the company also means that the *subscribed* capital and not the *paid-in* capital is relevant. Only the former criterion is representative for the level of investment in the subsidiary. Finally, the FTA Guidelines (Art. 15)[92] provide that, in order to compute the 25 per cent threshold, all types of equity investments must be taken into account: ordinary shares, participation certificates and profit sharing certificates.[93] The same holds true as regards loan re-characterized as equity

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[84] *Aktiengesellschaft (société anonyme)/Gesellschaft mit beschränkter Haftung (société à responsabilité limitée)/Kommanditaktiengesellschaft (société en commandite par actions).*

[85] Art. 4(1), lit. b of the WHTL.

[86] Oberson, see n. 1 above, p. 114. The FTA Guidelines (Art. 15, s. 9, lit. b), also admit that, as long as no other list is available, the list enclosed to the Parent-Subsidiary Directive must be used.

[87] Robert Waldburger, 'Satz der residualen Verrechnungssteuer bei Dividendenzahlungen an ausländische Personengesellschaften', in *IFF Forum für Steuerrecht* 2002, no. 1, p. 34.

[88] See above.

[89] On this issue for the Parent-Subsidiary Directive, see Cécile Brokelind, *Une interprétation de la directive sociétés mères et filiales du 23 juillet 1990*, Lund 2000, p. 142.

[90] See above.

[91] The economical and not the voting rights are relevant to compute the threshold for the application of the *participation exemption* in the case of dividends and capital gains (Arts. 69 and 70 of the Direct federal tax law – DFTL), for tax free transfers of investments (Art. 61(1), lit. d and Art. 61(3)of DFTL), etc. See in particular Guideline 9/1998 issued by the Federal tax administration on participation exemption for dividends and capital gains on the disposal of qualifying participations, 2.3.3., p. 4.

[92] FTA Guidelines (Art. 15, s. 4).

[93] '*Genussscheine*; *bons de jouissance*' according to Art. 657 of the Swiss Code of Obligation; the FTA Guidelines (Art. 15, s. 4) require that the existence of these certificates is justified by specific documents.

under thin-capitalization rules.[94] This approach, which is in line with the Parent-Subsidiary Directive,[95] thus implies that the benefit of Art. 15 should be granted even if the holding threshold is reached as a result of a reclassification of a loan into constructive equity.

7. Two-year holding requirement

Article 15(1) requires a two-year ownership period in the paying subsidiary. This requirement is also implemented in the Parent-Subsidiary Directive, where Art. 3(2) allows Member States to introduce a similar rule. Under EC law, the question came up as to whether, under this condition, the withholding tax could be avoided after two years only, or whether the relief could already be requested earlier provided the shares would be held during at least a two-year period. This question was brought up to the ECJ in the famous *Denkavit* case.[96] The Court ruled that:

> '...Member States cannot make the grant of the tax advantage provided for by Article 5(1) of the [Parent-Subsidiary Directive] subject to the condition that, at the moment when profits are distributed, the parent company should have had a holding in the subsidiary during the minimum period laid down pursuant to Article 3(2) [of the Parent-Subsidiary Directive], so long as this period is subsequently observed.'[97]

This interpretation of the two-year holding period also applies under Art. 15(1) of the Agreement.[98] As stated by the Advocate General,[99] the purpose of this minimum holding period is to avoid short-term concentration of non-qualifying small holdings in order to temporarily exceed the 25 per cent threshold. Such an abusive situation can, however, also be avoided by requiring that the participation be held for a two-year period after the payment of the dividend benefiting from the Agreement. In addition, the application of the *Denkavit* rule is also confirmed by the wording of the Agreement. The use of the present '...the parent has a direct minimum holding ... for at least two years ...' indicates that the qualifying holding does not necessarily need to have been held during two years at the time of the distribution. This argument was already used by the Advocate General and by the ECJ in the *Denkavit* case.[100]

Consequently, the Swiss tax authorities expressly accept the *Denkavit* practice and the granting of the advantage of the Agreement before the expiration of the two-year period.[101] However, if the dividend is due before the end of this period of time,[102] the Swiss distributing company has to pay to the FTA the amount of withholding tax due as if Art. 15 of the Agreement was not applicable (i.e. the residual withholding tax due based on the relevant double tax treaty or 35 per cent if no treaty applies). The withholding tax so paid will be refunded to the foreign parent company, as the case may be, upon request after the expiration of the two-year period.

As no transitional rule provides for the contrary,[103] the benefits of the Agreement can be claimed for, irrespective as to whether the subsidiary has been held during two years before the entry into force of Art. 15. This derives logically from the interpretation of the purpose of the two-year restriction period.

8. Anti-abuse provisions

A. General remarks

Article 15(1) begins with a reserve for '... the application of domestic or agreement-based provisions for the prevention of fraud or abuse ...', the wording of which corresponds to Art. 1(2) of the Parent-Subsidiary Directive. As already mentioned here above,[104] it therefore appears clearly that the interpretation of this provision will have to be made in light of the Parent-Subsidiary Directive.[105] On the one hand, like the Parent-Subsidiary Directive, the Agreement does not provide for a definition of *fraud* and *abuse*. Moreover, the wording of the Directive and of the Agreement explicitly refer to the domestic and bilateral anti-abuse provisions applicable in Switzerland and in

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94 FTA Guidelines (Art. 15, s. 4 *in fine*).

95 Helminen, 2000a, see n. 32 above, p. 331; Bell, see n. 34 above, p. 24; Terra and Wattel, see n. 32 above, p. 514.

96 *Denkavit International BV v Bundesamt für Finanzen*, C-283/94 (C-291/94 ; C-292/94), ECJ.

97 *Ibid*., s. 32.

98 Hull, see n. 24 above, p. 73.

99 Opinion of Advocate General Jacobs delivered on 2 May 1996 (*Denkavit* case; ECJ 1996 I 5063), s. 39; see also Hull, n. 24 above, 2005, p. 73.

100 Opinion of Advocate General Jacobs, s. 36; *Denkavit International BV v Bundesamt für Finanzen*, C-283/94, ECJ, s. 25; see also Guglielmo Maisto, 'The EC Court's Interpretation of the Parent-Subsidiary Directive under the *Denkavit* Case', *Intertax* 1997, no. 5, p. 183.

101 FTA Guidelines (Art. 15, s. 5); see also Guideline 10/2005 issued by the Federal tax administration on 15 July 2005.

102 According to the FTA Guidelines (Art. 15, s. 11), the relevant criterium is not the payment as such but the due date of payment of the dividend.

103 Hull, see n. 24 above, p. 73.

104 See earlier in article.

105 It is however worth recalling that the anti-abuse provision of Art. 1(2) of the Parent-Subsidiary Directive also concerns the corporate income tax exemption for dividend received, which is not covered by the Agreement.

the Member States and does not seem to create an autonomous supranational anti-abuse provision.[106] On the other hand, this should not mean that the parties to the Agreement have the discretion to adopt any definition of *abuse* in their legislation. Indeed, doing so would allow a Country to unilaterally – and against the purpose of the treaty – exclude certain situations or companies from the scope of the Agreement by introducing a particularly wide definition of *abuse*.[107] To conciliate these two aspects, we are of the opinion that based on a supranational concept of abuse, the scope of the reference to domestic and bilateral law has to be defined on an autonomous basis. Within this scope, Switzerland and the Member States have the discretion to define and implement their own domestic and treaty anti-abuse rules.

To delimit the extent of the delegation to Member States, it is generally recognized[108] that a strict interpretation of the term should be applied and that it should take the purpose of the Agreement into account.[109] In this context, a controversy exists with respect to the Parent-Subsidiary Directive on the effect of the anti-abuse provision.[110] Certain authors, based in particular on the *Denkavit* case,[111] consider that the anti-abuse provision has no existence of its own and that governments can only deny the application of a favourable tax regime provided for in the Parent-Subsidiary Directive if this is based on a specific provision within the Directive.[112] Another approach is to consider that the anti-abuse clause has its own meaning and can be implemented by Member States. In this case, however, it cannot be used to broaden specific anti-abuse provisions already contained in the Parent-Subsidiary Directive.[113] Moreover, it may only be used to avoid abusive situations like, for instance, cases in which the EU parent appears not to be the beneficial owner of the dividend, it being understood that the mere fact that the shareholder is located outside the EU should not be sufficient to trigger an abusive situation.[114] In our view, the second approach is more convincing, in particular as far as Art. 15 of the Agreement is concerned. Indeed, the contents of Art. 15 clearly reserve the application of anti-abuse provisions. It is therefore necessary to define the scope of the reference by determining the extent of the anti-abuse provision.

B. Scope of abuse

It appears clearly that the term *fraud* has to be understood as a situation in which a taxpayer adopts an illegal behaviour with a view to deceiving the tax authorities. Traditionally the Swiss meaning of this term is narrow and concerns criminal situations that are not discussed herein.[115] Rather, our attention focuses on the concept of *abuse*.

Taking into account the close relationship existing between the Agreement and the Parent-Subsidiary Directive, it is important first to consider the concept of *abuse* under EU law. An extensive analysis of this concept was done by the Advocate General in the *Halifax* case.[116] After reviewing the case law dealing with this matter, he indicated that:

> '. . . assessment of the abuse is based on whether the right claimed is consonant with the purposes of the rules that formally give rise to it. The person claiming the right is barred from invoking it only to the extent to which the Community law provision formally conferring that right is relied upon for the achievement of "an improper advantage, manifestly contrary to the objective of that provision."[117] And further: ". . . this notion of abuse operates as a principle governing the interpretation of Community law . . .". What appears to be a decisive factor in affirming the existence of an abuse is the teleological scope of the Community rules invoked.'[118]

Based on the foregoing, a situation should be considered to be abusive if two cumulative conditions are met: a *subjective* one and an *objective* one.[119] The

Notes

106 Terra and Wattel, see n. 32 above, p. 525; Hull, see n. 24, p. 74.

107 Brigitte Knobbe-Keuk, 'The EC corporate tax directives – anti-abuse provisions, direct effect, German implementation law', in *Intertax* 1992, nos. 8-9, p. 488; Dennis Weber, 'A closer look at the general anti-abuse clause in the Parent-Subsidiary Directive and the Merger Directive', in *EC Tax Review* 1996, no. 2, p. 64.

108 Knobbe-Keuk, see n. 107 above, p. 489; Brokelind, see n. 89 above, p. 203 ; Brokelind, see n. 48 above, p. 162; Maisto, see n. 22 above, p. 184 ; *Denkavit International BV v Bundesamt für Finanzen*, C-283/94, ECJ, s. 27. Other opinion: Oliver, n. 74 above, p. 216.

109 On this teleological approach, see Maisto, n. 22 above, p. 1997, p. 184.

110 Art. 1(2) of the Parent-Subsidiary Directive.

111 In particular *Denkavit International BV v Bundesamt für Finanzen*, C-283/94, ECJ, s. 31.

112 Brokelind, see n. 89 above, p. 223; Bokelind, see n. 48 above, p. 162.

113 Terra and Wattel, see n. 32 above, p. 526.

114 Knobbe-Keuk, see n. 107 above, p. 489.

115 See Oberson, n. 1 above, p. 112.

116 Opinion of Advocate General Poiares Maduro delivered on 7 April 2005 in *Halifax Plc v Commissioners of Customs and Excise*, C-255/02, ECJ (Advocate General, case *Halifax*).

117 Advocate General, case *Halifax*, s. 67.

118 Advocate General, case *Halifax*, s. 68.

119 Advocate General, case *Halifax*, s. 86; see also Terra and Wattel, n. 32 above, p. 144.

first condition should be considered fulfilled if the structure under assessment has no other economical purpose than obtaining a tax benefit, if it appears to be 'wholly artificial'[120] and cannot resist a 'commercial-purpose-test'.[121] The second (objective) criterion consists in comparing the purpose and results achieved by the activity at issue with the purpose and objectives of the rule invoked. It is only if 'granting the benefits would be at odds with the object and purpose of the EC law rule invoked . . .'[122] that abuse can be asserted. Abuse therefore means that circumstances lead to the consideration that the situation is artificial and only pursue the objective of benefiting from Community law.[123] The concept of abuse is, thus, closely related to the purpose of the rule that might be used abusively.

The objective of the Parent-Subsidiary Directive is to eliminate any downside resulting from cooperation between companies of different Member States as compared with cooperation between companies of the same Member State, and hence to facilitate cross-border cooperation.[124] The objective is to create conditions within the Community that correspond to those of a domestic market.[125] The question as to whether a structure should be considered as abusive should therefore be analysed as if the parent and the subsidiary were to be located both in the same jurisdiction. A country should not make it more difficult for companies in two different Member States to apply the Parent-Subsidiary Directive than to avail themselves of similar rights of a strictly domestic nature in situations of possible abuse.[126] As Art. 15 pursues the objective of extending the advantage of the Parent-Subsidiary Directive to Switzerland,[127] its purpose is also to create – under the conditions of the Agreement – a situation in which the companies in different jurisdictions should find themselves in a position similar to domestic relationships. In the context of the Agreement also, the question of abuse should therefore be analysed as if the two companies were both located in the same domestic jurisdiction.

Furthermore, considering the definition of abuse, it appears that the analysis as to whether a situation should be considered as abusive or not should be performed on a case-by-case basis and therefore cannot be determined in advance under general terms.[128] States often introduce anti-abuse provisions drafted in general and abstract terms and providing for general exclusion of certain structures. In this case, authors consider that the provision has to foresee an 'escape clause' allowing a demonstration that the transaction has a real business purpose and does not only pursue treaty shopping objectives; this is necessary to meet the principle of proportionality.[129] The French anti-abuse provision[130] is in this respect an illustrative example. It prevents the application of the Parent-Subsidiary Directive if the parent is controlled directly or indirectly by non-EU residents, except if it can be demonstrated that the structure does not pursue treaty shopping purposes.[131]

C. Swiss domestic anti-abuse provisions

It is important to note that, at the time of the publication of this article, Switzerland has not implemented a specific anti-abuse provision dealing with the application of Art. 15 of the Agreement. To prevent abusive treaty shopping on outbound dividend distributions, the Swiss authorities should therefore rely on existing domestic regulations. The question consists of determining, of course, whether such provisions can be found in the Swiss legislative framework.

1. The 1962 anti-abuse Decree

In 1962 Switzerland introduced in its domestic legislation a Decree[132] according to which treaty protection is denied if certain conditions are fulfilled. These provisions, however, remain ineffective against abusive situation in which Switzerland is the source country, as it only applies to situations where Switzerland is the beneficiary of the income for which treaty benefits are claimed (inbound dividends). The concept of the 1962 Decree was, however, implemented in certain DTCs concluded by Switzerland. The

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[120] Terra and Wattel, n. 32 above, p. 144.

[121] Weber, see n. 107 above, p. 65.

[122] Terra and Wattel, see n. 32 above, p. 145.

[123] Advocate General, case *Halifax*, s. 70.

[124] *Denkavit International BV v Bundesamt für Finanzen*, C-283/94, ECJ, s. 22.

[125] Knobbe-Keuk, see n. 107 above, p. 489.

[126] Terra and Wattel, see n. 32 above, p. 527.

[127] See earlier in article.

[128] Weber, see n. 107 above, p. 66.

[129] Weber, n. 107 above, p. 67; Terra and Wattel, n. 32 above, p. 366; Brokelind, see n. 89 above, p. 226.

[130] Art. 119*ter*(3) of CGI (*Code Général des Impôts*).

[131] See also Brokelind, see n. 89 above, p. 251.

[132] Decree of the Federal Counsel on Measures against the Improper Use of Tax Treaties concluded by the Swiss Confederation, adopted on 14 December 1962 (1962 Decree).

effects of these clauses are discussed later in this article.[133]

Even for inbound dividends,[134] it is unclear as to whether the 1962 Decree could apply so as to restrict the scope of Art. 15 of the Agreement. One argument that is commonly claimed in order to restrict its scope in connection with the Agreement is the fact that the 1962 Decree was implemented with the objective of limiting the application of bilateral treaties and cannot, therefore, have effect on the Agreement. The FTA does not share this point of view and considers that the 1962 Decree also applies to Art. 15 of the Agreement, as it shall be deemed to represent a multilateral 'tax treaty'. Considering the objective of the 1962 Decree – the avoidance of the improper application of tax treaties – we must admit that the point of view of the Swiss tax authorities seems reasonable. However, taking into account the scope of the reference to domestic law in Art. 15,[135] the application of the 1962 Decree should not be done purely objectively. Even if the criteria listed in the 1962 Decree and the Federal application guidelines are met, the applicant should be entitled to demonstrate that the structure was not set up with the sole purpose of benefiting from Art. 15. The introduction of such an 'escape clause' which does not correspond to the current practice of the Swiss authorities is necessary for complying with the proportionality principle. In our opinion, it is also compatible with the text of the 1962 Decree.[136] The demonstration that a structure is not abusive should in particular be achieved if the funds 'transiting' through Switzerland benefit to another Member State.

2. Strict interpretation of 'beneficial ownership'

Another question that deserves attention is whether, the benefit of Art. 15(1) is subject to the traditional 'beneficial ownership' requirement embodied in Art. 10 of the OECD MC since 1977. Indeed, unlike this provision, the text of Art. 15(1) does not refer to 'beneficial ownership'. The FTA, however, is of the opinion that this requirement is a general condition to claim treaty protection and, therefore, that it is implicitly contained in Art. 15(1).[137] This opinion, which corresponds to a clear trend of Swiss courts,[138] is however debatable. As a matter of fact, the need expressly to include this requirement in the text of the OECD MC in 1977 (as opposed for example to simply clarifying this in the OECD Commentary), may contradict this opinion. Further, as argued by certain authors, the expression 'beneficial ownership' has a scope of its own and does not, in particular, coincide with the term 'paid to' which focuses on the issue of personal attribution of income.[139] The OECD Commentary, as a result of its 2003 update, on the other hand, suggests the contrary by stating that the 'beneficial ownership' requirement is simply designed to clarify the terms 'paid . . .to a resident of the other contracting State'.[140]

This being said, the foregoing debate may be left opened in the context of Art. 15(1). Indeed, it should be borne in mind that this provision reserves domestic anti-abuse provisions. As mentioned above,[141] the purpose of Art. 15 of the Agreement is to achieve, between Switzerland and the EU Member States, a situation similar to domestic relationships. It seems therefore necessary to consider Art. 21(1), lit. a of WHTL – that states that the Swiss withholding tax can only be recovered by another Swiss resident if the latter is the beneficial owner of this income[142] – and to allow its application *by analogy*[143] on cases in which the application of Art. 15 is requested. In order to avoid any misunderstanding, it is worth clarifying that Art. 21 of WHTL does not override Art. 15 of the Agreement. The latter refers to domestic law and, by doing so, allows the use of Art. 21 of WHTL. Finally, although the Parent-Subsidiary Directive does not refer to 'beneficial ownership', it is generally accepted that this condition may, in the context of the reservation of domestic anti-abuse provisions, also be used to tackle 'directive-shopping'.[144] A teleological interpretation of Art. 15(1) on the basis of the Parent-Subsidiary Directive, therefore confirms that this rule is indeed subject to a beneficial ownership requirement.

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[133] See later in article.

[134] And other treaty protected income for which a Swiss company would ask the relief of foreign withholding taxes.

[135] See earlier in article.

[136] Art. 1(2) of the 1962 Decree states that the use of a treaty is improper if (a) the conditions stated in the treaty are not met and (b) if it is abusive.

[137] FTA Guidelines (Art. 15, s. 10).

[138] See decision of the Federal Appeal Commission dated 28 February 2001, VPB 65.86; decision of the Federal Appeal Commission dated 3 March 2005 (CRC 2003-159); see also in the same vein Xavier Oberson and Howard Hull, *Switzerland in International Tax Law* (Amsterdam, 2001), p. 120; Xavier Oberson, 'La notion de bénéficiaire effectif en droit fiscal international', in: *Festschrift SRK – Mélanges CRC* (Lausanne, 2004), p. 223.

[139] See Danon and Salome, n. 50 above, p. 342. In the same vein, Oberson, n. 138 above, p. 226.

[140] OECD Model Commentary, para. 12 and Art. 10 of the OECD MC.

[141] See earlier in article.

[142] The German text of Art. 21(a), lit. a of WHTL uses the term '*Recht zur Nutzung*' which is the translation of '*beneficial owner*'. Oberson, n. 138 above, p. 228 considers that 'beneficial ownership' under treaty law and Art. 21(1), lit. a of WHTL do not coincide exactly but admits that in practice both concepts lead to the same result.

[143] Due to the fact that Art. 21 of WHTL is applicable to Swiss resident claiming refund, the use to international situation can only take place by analogy.

[144] Terra and Wattel, see n. 32 above, p. 526.

The idea underlying the use of the concept of 'beneficial ownership' is to adopt an economical approach focusing on the control exercized by the recipient of the income[145] in order to avoid abuse.[146] Doing so prevents formally interposing a parent company in a Member State just for benefiting from the Agreement. The company claiming the application of Art. 15 needs, on the contrary, to be the economical owner of the income received, i.e. to be free to decide whether or not the capital should be used or made available for use by others or how the yields should be used, or both.[147] This definition based on the control over the income for which withholding tax could be levied corresponds to the definition of the persons entitled to claim a refund under Art. 21(1), lit. a of WHTL.[148] Due to the fact that the concept of beneficial ownership is used primarily to avoid treaty shopping, it is of course necessary to apply it in a restrictive manner and based on the facts and circumstances of each particular situation.[149] The beneficial ownership might in particular be denied where a specific arrangement exists between the apparent owner and the entity owning the economical rights over the income.[150] On the other hand, the mere fact that the beneficiary of a dividend is a company which is itself held by an ultimate parent company incorporated outside the EU or outside Switzerland, and to which it distributes its profits, cannot, as such, be considered to be a criterion sufficient for denying the beneficial ownership.[151] It is only if the structure appears to be abusive that the protection of the Agreement should be denied. It therefore appears clear that the question of the beneficial ownership is closely related to the concept of *abuse*. Indeed, in most cases where the issue of the effective beneficiary was raised, the Swiss courts also analysed the situation from the standpoint of the treaty shopping issue.[152]

3. Application of domestic anti-abuse provision

The concept of *abuse* is well known in Swiss tax law. According to the Federal Supreme Court,[153] a situation represents a *tax avoidance*[154] if:

(i) the structure is organized in an odd, inadequate or unusual way,
(ii) in order to save taxes, and
(iii) the construction effectively allows to achieve a significant tax saving.

If these three conditions are cumulatively met, it means that the structure creates a tax advantage for the taxpayer due to a loophole in the law;[155] by adopting a substance-over-form practice, tax avoidance will be avoided. This domestic definition of tax avoidance is very close to the one given by the Advocate General in the *Halifax* case.[156] The two first criteria correspond to what is defined in this case as the *subjective* element, i.e. an artificial set up created with a view to saving taxes. Regarding the *objective* component under EU understanding, i.e. the teleological analysis of the result of the application of the rule, it also applies under the Swiss concept of tax avoidance. Here also, the purpose of the provision that is abusively claimed has to be taken into account in order to determine whether the structure effectively allows to save taxes (condition (iii)). Therefore, the Swiss concept of tax avoidance fits within the scope of the reference under Art. 15 of the Agreement.

The FTA[157] considers that the abuse mentioned under Art. 15 of the Agreement corresponds to Art. 2, para. 2 of the Swiss Civil Code, i.e. the provision introducing the principle of abuse of law in the Swiss legal system. This is appropriate as the concept of tax avoidance ultimately relies on this principle.[158] However, it is too far away from the tax reality to be

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145 In international treaty situations see, Klaus Vogel, *A Commentary to the OECD-, UN- and US Model Conventions for the Avoidance of Double Taxation on Income and Capital*, 3rd ed. (London, 1997), no. 8 and Preface to Arts. 10–12 and Klaus Vogel and Moris Lehner, *Doppelbesteuerungsabkommen – Kommentar* (München, 2003), no. 17 and *Vorbemerkungen zu Artikel 10 bis 12*; Danon, n. 64 above, p. 337. For the Swiss situation, see Maja Bauer-Balmelli, in Zweifel and Athanas, *Kommentar zum Schweizerischen Steuerrecht II/2, Bundesgesetz über die Verrechnungssteuer* (Zurich, 2005), no. 8 ad Art. 21.

146 Vogel, see n. 145 above, no. 6 and Preface to Arts. 10–12; Vogel and Lehner, see n. 145 above, no. 12 and *Vorbemerkungen zu Artikel 10 bis 12*; OECD Model Commentary, para. 10 and. Art. 1 of the OECD MC; Oberson, see n. 138 above, p. 225.

147 Vogel, see n. 145 above, no. 9 and Preface to Arts. 10–12; Vogel and Lehner, see n. 145 above, no. 18 and *Vorbemerkungen zu Artikel 10 bis 12*; Danon, see n. 64 above, p. 337; Oberson, see n. 138 above, p. 226.

148 Bauer-Balmelli, see n. 145 above, no. 12 ad Art. 21.

149 Oberson, see n. 138 above, p. 227; Bauer-Balmelli, n. 145 above, no. 12 ad Art. 21.

150 Oberson, see n. 138 above, p. 227.

151 Vogel, see n. 145 above, no. 10 and Preface to Arts. 10–12; Vogel and Lehner, see n. 145 above, no. 19 and *Vorbemerkungen zu Artikel 10 bis 12*.

152 Bauer-Balmelli, see n. 145 above, no. 13 ad Art. 21; see also the two decisions of the Federal Appeal Commission, n. above.

153 On the question of abuse in general, see Pierre-Marie Glauser, *Apports et impôts sur le bénéfice, Le principe de déterminance dans le contexte des apports et autres contributions de tiers* (Zurich/Geneva, 2005), chapter 3.2.3.2.3. For an overview of abuse in the context of the Swiss withholding tax, see Bauer-Balmelli, n. 145 above, no. 36 ad Art. 21.

154 *Steuerumgehung* or *évasion fiscale*.

155 On this point, see Locher, *Grenzen der Rechtsfindung im Steuerrecht* (Bern, 1983), p. 196.

156 See earlier in article.

157 FTA Guidelines (Art. 15, s. 10).

158 Locher, see n. 155 above, p. 198.

applicable directly on Art. 15. In addition the Swiss tax law contains a legal provision which, in our opinion, is much more adequate to prevent abusive situations in the context of Art. 15. Indeed Art. 21, para. 2 of WHTL explicitly provides that 'Refund [of Swiss withholding tax] is unacceptable in all cases where it would lead to tax avoidance'. Of course, this provision concerns domestic refund of withholding tax and is not directly applicable to international situations when benefits of DTCs are claimed.[159] In the case of Art. 15 of the Agreement, however, the treaty explicitly refers to 'domestic provisions for the prevention of ... abuse'. As we have seen here above, the concept of tax avoidance under Swiss law corresponds to what the reference in Art. 15 seeks to avoid. It therefore seems appropriate to apply Art. 21, para. 2 of WTHTL by analogy, in particular considering the objective of the Agreement which is to create on an international basis a situation that correspond to the domestic reality.

Two elements, however, need to be kept in mind. First, tax avoidance must remain exceptional, hence restricted to extreme cases,[160] and should only be decided on a case-by-case basis (when it appears that the structure obviously does not have any business purpose[161]). Second, the structure must lead to an effective tax saving. This means for instance that tax avoidance should not disqualify the application of Art. 15 in favour of a parent company in a Member State A with the sole argument that it allows another company in a Member State B to benefit from the income.

D. Treaty based anti-abuse provisions

If Art. 15(1) of the Agreement introduces a reserve for 'agreement based' anti-abuse provisions, Art. 15(3) also states that 'existing double taxation agreements between Switzerland and the Member States which provide for a more favorable taxation treatment of dividends, interests and royalties payments at the time of adoption of this Agreement shall remain unaffected'. The FTA draws two correct statements out of this provision.[162] First the companies falling within the scope of the Agreement can choose between the application of Art. 15 or – if more favourable – of a specific DTC. Secondly, a specific provision in a DTC can only limit the application of Art. 15 if it was introduced *after* the entry into force of the latter provision[163] (*lex posterior derogat priori*).

Specific conditions outstanding in DTCs at the time of entry into force of the Agreement and introducing additional requirements to benefit from a full withholding tax relief than the one provided by Art. 15 therefore do not apply anymore. For instance, if a Swiss subsidiary is held by a French parent company owned itself by a US company, Art. 15 of the Agreement allows to avoid entirely the Swiss withholding tax, although the Swiss-French DTC[164] may, in this case, lead to a non-refundable Swiss withholding tax of 15 per cent.

This situation makes sense. The objective of the Agreement being to extend the effects of the Parent-Subsidiary Directive to Switzerland for withholding taxes, the application of specific double tax treaty provisions entered into with certain Member States would lead to different results depending on the place of incorporation of the parent company in the EU. This would obviously be contrary to the objective of Art. 15. Like in the EU, the Agreement shall prevail over DTCs.[165] Furthermore, 'limitation of benefit' clauses can, indeed, not be seen as anti-abuse rules as defined here above,[166] as they introduce objective restrictions and do not provide for an 'escape clause'.

The question then arises as to whether specific anti-abuse rules contained in DTCs concluded by Switzerland prior to the entry into force of the Agreement are still applicable and can limit the application of Art. 15. Due to the wording of Art. 15, there is little doubt that real anti-abuse provisions included in tax treaties could apply. The issue is whether treaties entered into by Switzerland contain such provisions that would introduce additional limitations than the ones existing under domestic law.

The DTC entered into with the Netherlands includes for instance an anti-abuse provision[167] allowing the Contracting States to deny treaty protection if a company was established in a Contracting State primarily to benefit from the treaty. The range of such an anti-abuse provision does not go beyond what Art.

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159 See Bauer-Balmelli, see n. 145 above, no. 57 ad Art. 21; decision of the Federal Appeal Commission dated 3 March 2005 (CRC 2003-159), s. 3.e.bb. The Commission in particular recalls that treaty law overrides national legislation.

160 Ernst Blumenstein and Peter Locher, *System des schweizerischen Steuerrechts*, 6th ed. (Zurich, 2002), 33 limit it to '*extrem krasse Fälle*'.

161 See earlier in article.

162 FTA Guidelines (Art. 15, s. 13).

163 1 July 2005.

164 Art. 11(2), lit. b of the Swiss-French DTC.

165 Regarding the relationship between the Parent-Subsidiary Directive and double tax treaties see among others: *Compagnie de Saint-Gobain v Finanzamt Aachen-Innenstadt*, C-307/97, ECJ, s. 57; Laurent Olléon, 'Déductibilité des intérêts, traité de Rome et conventions fiscales', in RJF 2003, no. 3, p. 194; Brokelind, n. 44; Giovanni Rolle, 'Is corporate income tax a withholding tax? Some comments on the Athinaïki Zythopoïïa case', in *EC Tax Review* 2003, no. 1, p. 42; Brokelind, see n. 48, p. 165.

166 See earlier in article.

167 Art. 9(2), lit. a(i) of the Netherlands-Swiss DTC.

21, para. 2 of WHTL already allows, and it does not introduce a more restrictive element. Treaties entered into with France,[168] Belgium[169] and Italy[170] include a provision corresponding to the restrictions introduced by the 1962 Decree into the respective tax treaties. This means that treaty protection is denied for relief of withholding tax on dividends, interests and royalties under certain objective conditions.[171] Although the Swiss tax authorities believe that these specific provisions still apply,[172] we are of the opinion that they no longer have effect since the entry intro force of Art. 15 of the Agreement. Either these provisions are autonomous, have an objective effect and are therefore still applicable if their criteria are fulfilled. They then exceed the scope of the anti-abuse provision in Art. 15 as defined here above and cannot override Art. 15.[173] Or one considers that they represent a real anti-abuse provision, but then the taxpayer must have the possibility to demonstrate that the structure is not abusive. In this case the effect of these special treaty provisions cannot go much beyond the limitations set by the tax avoidance rule (Art. 21, para. 2 of WHTL). At most they can represent an inversion of the burden of the proof as the companies would then have to demonstrate the absence of treaty shopping.

9. Subject to tax requirements

Like Art. 2(1), lit. c of the Parent-Subsidiary Directive, Art. 15(1) contains a subject-to-tax clause requiring that both (the paying and the receiving) companies are subject to corporation tax without being exempted. This requirement is therefore also relevant from the perspective of the Swiss distributing company.

Considering the complex Swiss tax system based on several layers of tax authorities[174] and containing various tax regimes, this provision initially triggered an important uncertainty.[175] With the publication of the FTA Guidelines (Art. 15)[176] the situation is now much clearer. The subject-to-tax clause relates to corporation tax levied on the income[177] and does not concern taxes computed independently from the amount of profit realized by the entity, like net wealth tax, business taxes, VAT, etc.[178] In this respect, the Swiss tax authorities have taken the position that the exemption mentioned under Art. 15 refers to the subjective tax liability. This means that a company will fall outside of the scope of the Agreement if it is not liable to pay any tax.[179] On the other hand, if the entity is considered as a taxpayer, it will qualify for the application of Art. 15 of the Agreement, even if its tax base is computed in a particular way and excludes certain element (objective exemption). This interpretation corresponds to the wording of the Agreement and to what is generally admitted in the EU for the application of the Parent-Subsidiary Directive.[180] Consequently Swiss companies liable to pay taxes in Switzerland but benefiting from a special tax regime (holding companies, auxiliary companies, domicile companies) can still claim for the advantage of the Agreement on dividends paid and received,[181] provided of course that the other conditions of Art. 15(1) are met. This interpretation is also reinforced by the wording of Art. 15(2). As far as interest and royalty payments are concerned, the Agreement states that the application of Art. 15 requires the *objective* tax liability of these items of income,[182] which *a contrario* is not the case for dividends.

Notes

[168] Art. 14 of the French-Swiss DTC.

[169] Art. 22 of the Belgium-Swiss DTC.

[170] Art. 23 of the Italian-Swiss DTC.

[171] Treaty protection is denied if the parent is controlled by residents of another state and if – based on certain (base erosion) criteria like thin capitalization rules, payment of more than 50 per cent of the treaty protected income, etc. – the payments can benefit to these non-residents.

[172] See Website of the FTA, http://www.estv.admin.ch/data/dba/d/index.htm.

[173] See earlier in article.

[174] Federal, cantonal and municipal.

[175] Hull, see n. 24 above, p. 71.

[176] See FTA Guidelines (Art. 15, s. 8).

[177] FTA Guidelines (Art. 15, s. 8(a)(i)).

[178] For this question under the Parent-Subsidiary Directive, see Frans Vanistendael, 'Looking back: a decade of parent subsidiary directive – the case of Belgium', in *EC Tax Review* 2001, no. 3, p. 156.

[179] FTA Guidelines (Art. 15, s. 8(a)(ii)).

[180] See Vanistendael, n. 178 above, p. 156; see also the French guidelines on the application of the Parent-Subsidiary Directive (*Instruction du 3 août 1992, Revenus de capitaux mobiliers – Régime de la distribution – Régime fiscal des dividendes distribués aux sociétés mères d'Etats membres de la C.E.E., 4 J-2-92*) s. 25.

[181] See also Hull, n. 24 above, p. 72; Oberson, see n. 1 above, p. 113.

[182] Art. 15(2), indent 4: 'all companies are subject to corporation tax without being exempted *in particular on interest and royalty payments . . .*' (emphasis added).

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