Switzerland

Branch Reporter
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Summary and conclusions

In respect of the 2003 update of the OECD commentary on article 1, it appears that Swiss and international doctrines mainly take the view that the 2003 update is a U-turn from the OECD 1977 commentary. Taking into account the historic development of the OECD commentary between 1977 and 2003 and having interpreted and applied the principle of *pacta sunt servanda* in articles 26 and 27 of the Vienna Convention, this report arrives at a different conclusion. From an international law perspective, it is submitted that the 2003 update adopted a further elaborated interpretative approach of the principle of *pacta sunt servanda*.

Whether treaty provisions prevail over domestic anti-avoidance measures or whether there is a treaty override is a question arising under the domestic law of a particular state, notably under constitutional law; it is a much more complex legal issue than articles 26 and 27 of the Vienna Convention and the OECD commentary would suggest. The questions at issue are interpretation and primacy. On grounds of the domestic international interpretation method, the Federal Supreme Court may review the conformity of domestic anti-avoidance measures in federal tax law with the obligations created by tax treaties; in the case of an unavoidable conflict between anti-avoidance provisions in a federal tax statute and an obligation created by a tax treaty, the latter in principle prevails. The international interpretation method is the domestic counterpart of articles 26 and 27 of the Vienna Convention.

Due to the monism of the Swiss legal system, international law has to be considered as Swiss federal law. It is submitted that the abuse of a tax treaty is an abuse of domestic law. Furthermore, due to the rank of double tax treaties (DTCs) in the Swiss legal system, it is submitted that the domestic principle of prohibition of treaty abuse may be derived from the principle of prohibition of arbitrariness in article 9 of the 1999 Federal Constitution. The constitutional concept of treaty abuse counteracts wholly artificial arrangements, artificial tax avoidance schemes and other extreme cases of abuse of rights. The lack of substance (offices, employees, substantive business operations, etc.) in the other contracting state, notably letterbox companies, falls into the scope of treaty abuse. Following modern Swiss legal methodology, permissions to fill an apparent loophole in the law (*contra legem*) and to refuse the application of a treaty relief provision in the case of obvi-

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ous abuse of rights or an arbitrary interpretative result may be derived from the constitutional principle of prohibition of arbitrariness. It appears that this permission is an extraordinary exception to the constitutional principle of observance of federal acts and international law.

At a particular period of time in the history of Swiss treaty law, a uniform set of treaty anti-avoidance provisions can be recognized. However, over time there have developed different anti-avoidance approaches. Due to its traditional approach, Switzerland has been reluctant to adopt specific and in particular complex anti-avoidance provisions in its tax treaties. However, there is obviously a trend in international tax law to adopt specific and sometimes complex anti-avoidance provisions in tax treaties. There is no doubt that the 2003 update of the OECD commentary has influenced and accelerated this trend. It has also increasingly influenced Swiss tax treaty law. Not surprisingly, there has recently developed a new uniform set of treaty anti-avoidance provisions. One leg of this set is a transaction based anti-conduit measure; the other is an entity based look-through measure.

1. Domestic anti-avoidance provisions with an international scope

1.1. General overview

1.1.1. Judicial general anti-avoidance doctrine

There is no statutory anti-avoidance provision in Swiss federal individual and corporate income tax law. According to the doctrine of Ernst Blumenstein, legal references and, thus, the wording of a legal term used in a tax provision defines the limits of interpretation provided that no tax avoidance (*Steuerumgehung*) is present.[1] In his view, the general anti-avoidance doctrine is an aid to interpretation that exceptionally allows the substance over form interpretation of a legal term so that an appropriate taxation in accordance with the purpose of the tax provision results. Under this general anti-avoidance doctrine, the following three requirements must be met: the legal form chosen by the taxpayer is apparently unwarranted, inappropriate or unusual and, in all cases, completely inappropriate to the economic facts (the objective element); the choice was made merely with the intention of saving tax (the subjective element); and the method chosen would effectively lead to a substantial reduction in tax (the factual element).

In the leading case decided on 1 December 1933, the Federal Supreme Court has adopted this doctrine.[2] From that time on, tax avoidance has existed for Swiss individual and corporate income tax purposes if all three requirements are met. In such a case, the real facts are disregarded and replaced by those facts that would have been appropriate to achieve the intended objective. These deemed facts fulfil the statutory requirements of the taxable event and, consequently, trigger the

1 Ernst Blumenstein, 1939/40, pp. 161–195, 225–245, 273–291.
2 Federal Supreme Court, 1 December 1933, BGE 59 I 284.

taxable event. The legal basis of the judicial general anti-avoidance doctrine remains far from clear.

In contrast to Ernst Blumenstein's doctrine and the older Swiss legal methodology, modern Swiss legal methodology holds that the wording of a legal term used in a tax provision does not define the limits of interpretation and submits the development of law to means of interpretation at the level of the legal norm. The interpretation of a legal norm is a question of identifying its genuine meaning. Arguably, the purpose of the legal norm defines the limits of interpretation. The method of teleological interpretation searches for the purpose of law. Peter Locher concludes that if the wording of the legal term does not provide the limit of interpretation, there is no need for the judicial general anti-avoidance doctrine in order to arrive at appropriate taxation in accordance with the purpose of the legal norm.[3]

1.1.2. Abuse of rights doctrine

According to the prevailing Swiss doctrine, the principle of prohibition of abusive tax avoidance (*Verbot der rechtsmissbräuchlichen Steuerumgehung*) may be derived from article 2(2) of the 1907 Swiss Civil Code.[4] This article enshrines the principle of prohibition of abuse of rights (*Verbot des Rechtsmissbrauchs*) that prohibits the improper use of a right to obtain advantages which have not been conceived of for that right. This means that abuse of rights is present if the use of a right is obviously contrary to the purpose for which it has been granted.[5] The principle of prohibition of the abuse of rights is an *ultima ratio* measure that allows an apparent loophole in the law (*unechte Gesetzeslücke*) to be filled. In a bankruptcy case decided in 1994, the Federal Supreme Court explained this permission as follows:[6] an apparent loophole is a rule in the law that gives an answer to a question, but this answer is so unsatisfactory that the rule in the law should be adjusted. Only if the application of the rule in the law results in obvious abuse of rights may the court depart from the rule (*contra legem*). It appears that according to the Federal Supreme Court's case law, the filling of a loophole outside the scope of article 2(2) of the 1907 Swiss Civil Code is not permitted.

1.1.3. Prohibition of arbitrariness

Article 190 of the 1999 Federal Constitution enshrines the core principle of Swiss constitutional jurisdiction at federal level. It stipulates that the Federal Supreme Court and judicial authorities should apply federal acts and international law. Nevertheless, modern Swiss legal methodology derives the permissions to fill an apparent loophole in the law (*unechte Gesetzeslücke*) and to adjust a federal act (*contra legem*) in case of obvious abuse of rights from the principle of prohibition of arbitrariness in article 9 of the 1999 Federal Constitution; it appears that this

[3] Peter Locher, 2007/07, at p. 685.

[4] Thomas Gächter, 2005, at pp. 334 *et seq.*; Ernst Höhn and Robert Waldburger, 2001, at pp. 176 *et seq.*; Ernst Blumenstein and Peter Locher, 2002, at p. 33.

[5] Max Baumann, 1998, paras. 231 *et seq.* to art. 2; Gächter, *op. cit.*, at pp. 23 *et seq.*; Heinrich Honsell, 2006, paras. 1 *et seq.* to art. 2; Hans Merz, 1966, paras. 21 *et seq.* to art. 2.

[6] Federal Supreme Court, 25 October 1994, BGE 120 III 131.

permission is an extraordinary exception to the principle of observance (*Anwendungsgebot*) in article 190.[7] Thomas Gächter refers to the constitutional concept of practical concordance (*Konzept der praktischen Konkordanz*) that includes the principles of the unity of the Constitution and the equality of constitutional law.[8]

1.2. General anti-avoidance provisions with international focus or effect

Article 21(2) of the 1965 Federal Withholding Tax Act stipulates a specific statutory anti-avoidance provision in respect of an abusive tax refund. In 1970, the Federal Tax Administration announced that the judicial general anti-avoidance doctrine is taken into account for the interpretation of article 21(2).[9]

In 2008 the Federal Tax Administration announced that it would continue to apply article 21(2) also in the tax treaty context.[10] Conclusively, the judicial general anti-avoidance doctrine is given an indirect international effect. This means that the real facts are disregarded and a withholding tax refund claimed by the person resident in the other contracting state may be refused based on fictitious facts.

1.3. Specific anti-avoidance provisions with international focus or effect

1.3.1. Specific statutory anti-avoidance provisions

As mentioned above, the Federal Tax Administration applies article 21(2) of the 1965 Federal Withholding Tax Act also to tax treaties.[11] This international application of a specific statutory anti-avoidance provision is, however, highly questionable.

In the leading case decided in 1955, the Federal Supreme Court held that article 7(2) of the old 1943 Federal Decree on the Federal Withholding Tax prevents domestic defrauders and foreigners circumventing the statutory law that does not give them a claim for tax refund by transferring securities the yield of which is subject to withholding tax to a domestic third party who in turn obtains a tax refund.[12] The scope of the entitlement to refund of withholding tax in the provisions of the old 1940 Federal Decree on the Federal Defence Tax and the old 1943 Federal Decree on the Federal Withholding Tax was always in principle limited to domestic taxpayers. Arguably, taking into account this court's reasoning and the origin of the specific statutory anti-avoidance provision, it is submitted that article 21(2) of the 1965 Federal Withholding Tax Act is only applicable to the domestic context and, therefore, has no international effect in the treaty context.

7 Gächter, *op. cit.*, at pp. 378 *et seq.*; Walter Kälin, 2001, pp. 1167–1181, at p. 1180; Locher, *op. cit.*, at p. 690; Rene Mattoetti, 2007, at pp. 243 *et seq.*; Jörg Paul Müller, 2000, pp. 119–128, at p. 126; Felix Uhlmann, 2005, at pp. 249 and 252.

8 Gächter, *op. cit.*, at pp. 369 *et seq.*

9 Federal Tax Administration, 6 March 1970, in Peter Agner *et al.*, loose-leaf, art. 21(2), no 1.

10 Federal Tax Administration, 12 March 2008, in *ibid.*, no. 31.

11 *Ibid.*

12 Federal Supreme Court, *Aktiengesellschaft X*, 18 February 1955, 1954/55, pp. 528–538.

1.3.2. Beneficial ownership

In a case in 2008, the Federal Administrative Court had recourse to the case law on the domestic beneficiary requirement in article 21(1)(a) of the 1965 Federal Withholding Tax Act for the interpretation of the treaty term "beneficial ownership" in the 1971 Germany DTC so that the domestic term was given an international effect in the treaty context.[13] However, the point made elsewhere in this report is that the treaty term of beneficial ownership has an international fiscal meaning that is governed by an autonomous interpretation. Thus, article 21(1)(a) has no international effect in the treaty context. The Federal Commission of Appeal in Tax Matters applied such an autonomous interpretation in the Luxembourg case decided in 2001.[14]

1.3.3. 1962 Decree

In 1962, Switzerland enacted domestic anti-avoidance provisions to counter the improper use of its tax treaties by foreign taxpayers utilizing Swiss interposed companies to derive certain types of foreign income. The 1962 Decree aims to protect the interest of Switzerland's treaty partners where they are the source state of the income and Switzerland the residence state of the person claiming treaty relief. The use of treaty relief is deemed improper if the requirements specified in the treaty, such as residence, beneficial ownership, are not fulfilled, or if it constitutes an abuse. Article 2(1) of the 1962 Decree deems it an abuse by an individual, a legal person or a partnership resident in Switzerland if, through such a claim, a substantial part of the tax relief would benefit, directly or indirectly, persons not entitled to a tax treaty.

One of the criticisms addressed to the 1962 Decree and the 1962 circular is that their rules are rigid and that they do not take account of bona fide situations and may even deny treaty benefits where no abuse is present. In response to those criticisms the Federal Tax Administration issued an additional circular in 1999 that constitutes a modification of the 1962 circular. It provides for less strict rules for active companies, listed companies and holding companies and abolished the specific thin capitalization and arms length's interest rate rules. Instead, the 1999 circular refers to the general thin capitalization and arms length's interest rate rules.

1.3.4. Thin capitalization and interest rate rules

Thin capitalization and arm's length interest rate rules are specific domestic anti-avoidance measures that are also applied to the cross-border context and, thus, have international effect in the tax treaty context.

13 Federal Administrative Court, *A GmbH*, 30 October 2008, A-2163/2007.

14 Federal Commission of Appeal in Tax Matters, *V SA*, 28 February 2001, VPB 65.86 = *International Tax Law Reports* 4 (2002) pp. 191–214.

1.3.5. Old reserves doctrine

Recently, the Federal Tax Administration gave further explanation of its approach to the old reserves doctrine.[15] According to administrative practice, distribution of so-called old reserves (*Altreserven*) following a transfer of shares is subject to the treaty rate that was applicable prior to the share transfer if the following requirements are fulfilled: the transfer of shares in a Swiss company to a foreign or Swiss company within the group results in a lower residual withholding tax rate; the main purpose of the share transfer was the achievement of a more favourable tax position; and the economic purpose played a minor role only. The old reserves are determined at the time of the share transfer and amount to the smaller of either non-operational assets or retained earnings available for distribution.

The point made elsewhere in this report is that the transfer of shares to a foreign company does not come into the scope of article 21(2) of the 1965 Federal Withholding Tax Act. One might then argue that the old reserves doctrine may be derived in the treaty context from the judicial general anti-avoidance doctrine. It appears that the Federal Tax Administration invokes the judicial general anti-avoidance doctrine so that it is given a direct international effect in the treaty context.[16] However, the Federal Supreme Court's case law applies the judicial general anti-avoidance doctrine in domestic and non-treaty contexts (abusive avoidance of a domestic tax provision), but the abuse of rights doctrine in the treaty context (abusive use of a tax treaty relief provision).

1.4. The relationship between domestic anti-avoidance provisions and tax treaties

1.4.1. 1962 Decree

The question of treaty override in respect of the 1962 Decree arose in two Federal Supreme Court cases. Although the case law preceded the clarifications in the 2003 OECD commentary, it is consistent with the interpretative approach as argued in this report.

The first case was decided in 1968 and involved a Swiss company controlled by a German resident which received UK source royalties.[17] The court upheld the administration's assessment on grounds of prohibition of abuse of rights in article 2(2) of the 1907 Swiss Civil Code. The court concluded that article 2(2)(b) of the 1962 Decree did not conflict with the object and purpose of tax treaties.

The second case was decided in 1987, about twenty years after the first case and one year after the release of the 1986 conduit company and base company reports. This case involved four German taxpayers that had formed a Swiss partnership that owned all the shares of a Swiss holding company.[18] The Swiss company asked for

15 Sebastian Benz and Georg Lutz, ISIS Seminar on International Taxation, held in Zurich on 23 April 2009, handout, pp. 3 *et seq.*

16 Federal Tax Administration, 29 November 2004, in Walter Meier *et al.*, loose-leaf, B 10.2 no. 36.

17 Federal Supreme Court, *Christian Holzäpfel GmbH*, 22 November 1968, BGE 94 I 659.

18 Federal Supreme Court, *X AG*, 10 July 1987, BGE 113 Ib 195.

relief from Portuguese dividend withholding tax according to article 10 of the 1974 DTC with Portugal. The Federal Supreme Court upheld the administration's assessment on grounds that the 1962 Decree did not conflict with the purpose of tax treatues. The Federal Supreme Court referred to its ruling in 1968, but departed from its previous reasoning in respect of double non-taxation in the case of base companies. The court stated that according to article 2(2)(b) of the 1962 Decree an abuse was present if treaty relief was accumulated by a base company for the benefit of persons not entitled to treaty relief.

1.4.2. Article 21(1)(a) of the 1965 Federal Withholding Tax Act

In a case in 2008, the Federal Administrative Court had recourse to the case law on the domestic beneficial ownership requirement in article 21(1)(a) of the 1965 Federal Withholding Tax Act for the interpretation of the treaty term "beneficial ownership" under the 1971 Germany DTC so that the domestic term was given an international effect in the treaty context.[19]

Following the reasoning of the Federal Commission of Appeal in Tax Matters in a previous decision,[20] the point made in this report is that the treaty term of beneficial ownership has an international fiscal meaning that is governed by an autonomous interpretation.

1.4.3. Article 21(2) of the 1965 Federal Withholding Tax Act

The question of the relationship between article 21(2) of the 1965 Federal Withholding Tax Act and tax treaties arose under the 1973 Denmark DTC in respect of a transaction executed in 2000. Article 10(1) of the Denmark DTC provides for full relief from Swiss dividend withholding tax. In its decision in 2005, the Federal Commission of Appeals in Tax Matters refused the view of the Federal Tax Administration that refund of withholding tax may be refused on grounds of article 21(2) of the 1965 Federal Withholding Tax Act.[21] By this decision, the commission overruled its previous decision in the Luxembourg case in 2001 where it applied article 21(2) to the 1993 Luxembourg DTC. [22]

The point made elsewhere in this report is that article 21(2) is not applicable to a tax treaty. The reasoning is found in domestic law. Article 21(2) of the 1965 Federal Withholding Tax Act is only applicable to the domestic context and, therefore, has no international effect.

1.4.4. Interpretative approach

The 2003 update contains no material change and, consequently, no U-turn from the 1977 OECD commentary. Instead, it is submitted from an international law

[19] Federal Administrative Court, *A GmbH*, 30 October 2008, A-2163/2007.

[20] Federal Commission of Appeal in Tax Matters, *V SA*, 28 February 2001, VPB 65.86 = *International Tax Law Reports* 4 (2002) pp. 191–214.

[21] Federal Commission of Appeals in Tax Matters, *X Holding ApS*, 3 March 2005, SRK 2003-159.

[22] Federal Commission of Appeal in Tax Matters, *V SA*, 28 February 2001, VPB 65.86 = *International Tax Law Reports* 4 (2002) pp. 191–214.

perspective that the 2003 update adopted a further elaborated interpretative approach of the principle of *pacta sunt servanda* in articles 26 and 27 of the Vienna Convention. To put the principle of *pacta sunt servanda* the other way round clarifies the relationship between domestic and international law. The interpretative approach as argued in this report is defined as follows: (a) domestic anti-avoidance measures are, as a rule, applicable to a tax treaty, but their application is restricted by the obligations created by the tax treaty; (b) in the absence of a specific treaty provision allowing the application of domestic anti-avoidance measures or a corresponding observation or reservation respectively to the OECD commentary on article 1, domestic anti-avoidance measures are not applicable to a tax treaty *if* they conflict with the provisions of a tax treaty; (c) domestic anti-avoidance measures are in principle applicable to a tax treaty irrespective of whether their application would be restricted by the obligations created by the tax treaty if a tax treaty provides for a specific treaty provision allowing the application of domestic anti-avoidance measures or the contracting state that applies domestic anti-avoidance measures entered a corresponding observation or reservation respectively to the OECD commentary on article 1.[23] The guiding principle in paragraph 9(5) of the 2003 OECD commentary serves as an aid to interpretation. The guiding principle reflects the further elaborated approach of the 2003 update.

The application of domestic anti-avoidance measures to a tax treaty is governed by the interpretative approach irrespective of whether the tax treaty was concluded before or after the 2003 update.

1.4.5. International interpretation

Whether treaty provisions prevail over domestic anti-avoidance measures or whether there is a treaty override is a question arising under the domestic law of a particular state, notably under constitutional law, and it is a much more complex legal issue than articles 26 and 27 of the Vienna Convention and the OECD commentary would suggest. The questions at issue are interpretation and primacy.

A particular legal system has to decide how international law becomes part of domestic law. The Swiss legal system follows the theory of monism according to which international law becomes automatically and directly part of domestic law as international law.[24] Domestic and international law are parts of one legal system of which international law is an integral part.[25] The Federal Supreme Court has repeatedly held that international law has to be considered as Swiss federal law.[26] No formal transformation of international law into federal statute is required.

23 It seems that only Luxembourg's observation refuses the interpretative approach argued in this report. Luxembourg rejects the 2003 update and states that in the absence of an express provision in the tax treaty, it believes that a state can only apply its domestic anti-abuse provisions in specific cases after recourse to the mutual agreement procedure. See also the reservation entered by the USA in para. 11 of the 1977 OECD commentary and para. 28 of the 2000 OECD commentary on art. 1 according to which the USA reserved the right to tax its citizens and residents without regard to the convention.

24 Luzius Wildhaber and Stephan Breitenmoser, 1988, pp. 163–207, at pp. 171 *et seq.*; Pierre Tschannen, 2004, at p. 160.

25 Technical explanations to the 1999 Federal Constitution, BBl 1997 134.

26 Wildhaber and Breitenmoser, *op. cit.*, at pp. 196 *et seq.*

The relationship between a provision of a federal tax statute and article 6(2) of the ECHR Convention was at issue in the leading case decided by the Federal Supreme Court in 1991.[27] According to article 130(1) of the old 1940 Federal Decree on the Direct Federal Tax, heirs were jointly liable for the deceased person's evaded taxes and any fine incurred by him up to an amount not exceeding their share in the estate. The question arose of whether this liability conflicted with article 6(2) of the ECHR Convention. The court noted that articles 113(3) and 114*bis*(3) of the old 1874 Federal Constitution (which were adopted in article 190 of the 1999 Federal Constitution) stipulated that the Federal Supreme Court and other judicial authorities should apply federal acts and international treaty law. The court argued that article 114*bis*(3) of the old 1874 Federal Constitution did not prohibit the application of commonly recognized principles reconciling constitutional and international law, and then referred to articles 26 and 27 of the Vienna Convention that stipulate the principle of primacy of international law. The court argued that this principle required an interpretation of domestic law – including article 114*bis*(3) – in conformity with international law (*völkerrechtskonforme Auslegung*). The international interpretation method is the domestic counterpart of articles 26 and 27 of the Vienna Convention. The interpretative method requires that conflicts should be avoided as far as possible; in the case of an unavoidable conflict between a provision of a federal statute and international law, the latter prevails unless the federal legislator knowingly tolerated the conflict of international law.

On the grounds of this domestic international interpretation method the Federal Supreme Court may review the conformity of domestic anti-avoidance measures in federal tax law with the obligations created by tax treaties; in the case of an unavoidable conflict between anti-avoidance provisions in a federal tax statute and an obligation created by a tax treaty, the latter in principle prevails. The question of whether articles 21(1)(a) and 21(2) of the 1965 Federal Withholding Tax Act conflict with tax treaties does not, however, arise. The point made elsewhere in this report is that they are only applicable to the domestic context.

1.5. Abuse of the tax treaty itself: domestic law principles or interpretation of the treaty?

1.5.1. Abuse of tax treaty

In the Denmark case in 2005, the question also arose of whether an implicit reservation of treaty abuse could be derived through interpretation of the 1973 Denmark DTC applied to a transaction executed in 2000.[28] The Federal Supreme Court refused treaty relief under article 10(1) of the Denmark DTC on grounds of prohibition of treaty abuse that the court derived from article 31 of the Vienna Convention and an internationally accepted principle.[29] As an aid to interpretation for the question of whether treaty abuse was present, the court took account of the 2003 OECD commentary.

27 Federal Supreme Court, *Erben X*, 15 November 1992, BGE 117 Ib 367.

28 Federal Supreme Court, *X Holding ApS*, 28 November 2005, 2A.239/2005 = *International Tax Law Reports* 8 (2006), pp. 536–562.

29 In contrast to the court's findings, René Matteotti submits an absurdity test (*Absurditätstest*) that he derives from arts. 31 and 32 of the Vienna Convention and concludes that both the beneficial

Even though the legal basis in articles 31 and 32 of the Vienna Convention for the reference to the OECD commentary is far from clear, it would be hard to disagree with the court that the OECD commentary is an aid to the interpretation of tax treaties. This conclusion, of course, implies that treaty negotiators have the OECD commentary in front of them during the negotiations. It appears, however, that the assumption of a principle of prohibition of treaty abuse implicitly included in the tax treaty is contradictory to Switzerland's observation to paragraph 7 of the 2003 OECD commentary. The point made in this report is that the legal basis of the principle of prohibition of treaty abuse is neither the principle of good faith in article 31 of the Vienna Convention nor the treaty itself nor an internationally accepted principle and that the abuse of a tax treaty is an abuse of domestic law.

1.5.2. Prohibition of treaty abuse

Due to the monism of the Swiss legal system, international law has to be considered as Swiss federal law. Arguably, it is submitted that the abuse of a tax treaty is an abuse of domestic law. Conclusively, Switzerland falls into the category of OECD member countries in paragraph 9(2) of the 2003 OECD commentary (abuse of domestic law). Furthermore, due to the rank of tax treaties above federal statutes, but below the Federal Constitution, it is submitted that the domestic principle of prohibition of treaty abuse may be derived from the principle of prohibition of arbitrariness in article 9 of the 1999 Federal Constitution. Following modern Swiss legal methodology, permissions to fill an apparent loophole in the law (*unechte Gesetzeslücke*) and to refuse the application of a treaty relief provision (*contra legem*) in case of obvious abuse of rights or an arbitrary interpretative result may be derived from the constitutional principle of prohibition of arbitrariness; it appears that this permission is an extraordinary exception to the principle of observance of federal acts and international law (*Anwendungsgebot*) in article 190.[30]

The constitutional concept of treaty abuse counteracts wholly artificial arrangements, artificial tax avoidance schemes and other extreme cases of abuse of rights. If a taxpayer attempts to abuse a provision of a Swiss DTC, this abuse may be countered by applying the principle of prohibition of arbitrariness. Paragraph 7 of the 2003 OECD commentary and 1977 OECD commentary on article 1 state that the purpose of tax treaties is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons. A lack of substance (offices, employees, substantive business operations, etc.) in the other contracting state, notably letterbox companies, falls into the scope of treaty abuse.

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ownership requirement and the prohibition of treaty abuse are implicitly included in Swiss tax treaties. See René Matteotti, 2009, pp. 195–239, at pp. 226 *et seq.*

30 Gächter, *op. cit.*, at pp. 378 *et seq.*; Kälin, *op. cit.*, at p. 1180; Locher, *op. cit.*, at p. 690; Rene Matteotti, 2007, at pp. 243 *et seq.*; Müller, *op. cit.*, at p. 126; Uhlmann, *op. cit.*, at pp. 249 and 252.

2. General and specific anti-avoidance provisions in tax treaties

2.1. General overview

At a particular period of time in the history of Swiss treaty law, a uniform set of treaty anti-avoidance provisions can be recognized in Swiss DTCs. Over time, different anti-avoidance approaches have developed. The Federal Supreme Court has repeatedly countered tax avoidance by means of the judicial general anti-avoidance doctrine in the domestic and non-tax treaty contexts (abusive avoidance of a domestic tax provision) and by means of the abuse of rights doctrine in the tax treaty context (abusive use of a tax treaty relief provision). Furthermore, the unilateral 1962 Decree aims to protect the interest of Switzerland's treaty partners. Due to this traditional approach, Switzerland has been reluctant to adopt specific and in particular complex anti-avoidance provisions in its tax treaties.

However, there is obviously a trend in international tax law to adopt specific and sometimes complex treaty anti-avoidance provisions. There is no doubt that the 2003 update of the OECD commentary has influenced and accelerated this trend. It has also increasingly influenced Swiss tax treaty law. Not surprisingly, there has recently developed a new uniform set of treaty anti-avoidance provisions.[31] One leg of this set is a transaction based anti-conduit measure that was initially introduced in articles 3(1)(l), 10(6), 11(7), 12(5) and 21(4) of the 1977 UK DTC. The other is an entity based look-through measure. This kind of measure was initially introduced in the previous version of article 11(2)(b)(ii) of the France DTC (as it read after the amendment on 22 July 1997, but before the amendment on 28 August 2009)[32] and in a highly complex limitation on benefits clause in article 22 of the 1996 US DTC.

2.2. Specific treaty provisions allowing application of domestic anti-avoidance provisions

2.2.1. Reference to the application of the 1962 Decree

Paragraph 7 of the 1971 exchange of notes to the 1971 Japan DTC, paragraph (iv) to article 11 of the 1975 protocol to the 1975 Singapore DTC, paragraph 2 of the 1987 protocol to the 1987 Norway DTC, and paragraph 2 of article 23 of the 2002 protocol to the 1971 Germany DTC (as it reads after the amendment on 12 March 2002)[33]

31 Switzerland is in the process of revising several of its tax treaties. Some of the signed protocols have not yet been published in the official journal. Treaty anti-avoidance provisions included in not yet published protocols are not taken into account in this report. Furthermore, specific treaty provisions which are aimed at taxpayers benefiting from preferential tax regimes are not taken into account in this shorter version of the branch report.

32 Art. 11(2)(b)(ii) as its reads after the amendment by the Supplementary Agreement of 22 July 1997, in force since 1 August 1998, and before the amendment by the Supplementary Agreement of 28 August 2009, not yet entered into force.

33 Para. 2 to art. 23 of the protocol on art. 23 as it reads after the amendment by the protocol of 12 March 2002, in force since 24 March 2003.

provide for specific treaty provisions allowing the application of the 1962 Decree. As the application of the 1962 Decree to a tax treaty is in conformity with the Swiss obligations created by a tax treaty and as Switzerland applies the 1962 Decree to all its tax treaties, these references have only declaratory significance under the treaties.

Specific treaty provisions that are similar and relate to the 1962 Decree are included in article 14 of the 1966 France DTC (as it read before the amendment on 28 August 2009),[34] article 23 of the 1971 Germany DTC (as it reads before the amendment on 12 March 2002),[35] article 23 of the 1976 Italy DTC, and article 22 of the 1978 Belgium DTC. These treaties also include specific provisions allowing the application of more far-reaching domestic anti-avoidance provisions. This means that Switzerland applies the 1962 Decree to these treaties if a search for the common intentions of the treaty partners does not establish that they intended to agree to less strict specific treaty measures that prevail over those in the 1962 Decree according to the principle *lex specialis derogat legi generali*.

2.2.2. Domestic general anti-avoidance measures

Specific treaty provisions allowing the application of domestic anti-avoidance provisions are included in article 23(1) of the 1971 Germany DTC (as it reads after the amendment on 12 March 2002),[36] paragraph 8 (Entitlement to treaty benefits) of the 2003 protocol to the 2003 Israel DTC, and paragraph I(i) (Entitlement to treaty benefits) of the 2006 protocol to the 1966 Spain DTC.[37]

For example, according to a provision in the tax treaty with Germany the treaty should not be construed to prevent a contracting state from using its domestic provisions to prevent tax avoidance or tax evasion and if this provision results in double taxation the competent authorities should endeavour to avoid that double taxation. In the provision of the tax treaty with Spain the contracting states have declared that their domestic provisions and procedures with respect to the abuses of law (including tax treaties) may be applied to the treatment of such abuses.

These general references are important from the interpretative approach's perspective. They may have constitutive significance under tax treaties. Treaty override is permitted by the treaty itself. Arguably, from a Swiss perspective, the 1962 Decree, the thin capitalization and interest rate rules, the abuse of rights doctrine, and the prohibition of treaty abuse doctrine are in principle applicable to these treaties without any restrictions created by the treaties.

34 Art. 14 as it read before the amendment by the Supplementary Agreement of 28 August 2009, not yet entered into force.

35 Art. 23(1) as it read before the cancellation by the protocol of 12 March 2002, in force until 23 March 2003.

36 Art. 23(1) as it reads after the amendment by the protocol of 12 March 2002, in force since 24 March 2003.

37 Para. I(i) of the protocol of 29 June 2006, in force since 1 June 2007.

2.2.3. Controlled foreign company (CFC) rules

A specific treaty provision allowing the application of Spanish domestic CFC rules to the tax treaty is included in paragraph I(iii) (Entitlement to treaty benefits) of the 2006 protocol to the 1966 Spain DTC.[38]

As Switzerland entered an observation in paragraph 27(9) of the 2003 OECD commentary on article 1 in respect of the application of CFC rules, this provision may have not only declaratory, but also constitutive significance under the tax treaty in relation to Switzerland.

2.3. General anti-avoidance provisions in tax treaties – tax exemption

Articles 10(2)(b) and 12(7) of the 1966 Spain DTC[39] require for the exemption from source taxation of inter-company dividends and royalties respectively that the receiving company is subject to and not exempt from taxes. It appears that these measures relate to article 15 of the 2004 Switzerland–EC Savings Tax Agreement that in turn relates to the EC Parent–Subsidiary and Interest and Royalties directives.

2.4. Specific anti-avoidance provisions in tax treaties

2.4.1. Attribution rules

Articles 4(6)(a) of the 1966 France DTC, 4(5)(a) of the 1976 Italy DTC and 4(4)(1) of the 1978 Belgium DTC state that a person is not considered to be a resident of a contracting state for the purposes of the residence article who, although meeting the definition of the residence article, is only the apparent recipient of the income, this income actually benefiting, either directly or indirectly through other individuals or legal entities, a person who may not himself be considered a resident of said state under the residence article. It appears that the term "apparent recipient" has the same meaning as the treaty term "beneficial owner" in articles 10 to 12 of the OECD model.

A further attribution rule is included in article 4(11) of the 1971 Germany DTC. A person is deemed not to be a resident of a contracting state with respect to income and property which are not attributable to that person but to another person. One might conclude that this clause not only includes the beneficial ownership requirement in the residence article, but allows the application of domestic attribution rules that would, as a consequence, be in principle applicable to the tax treaty irrespective of whether their application were restricted by the obligations created by the treaty.[40] The technical explanations, however, point out that article 4(11)

38 Para. I(iii) of the protocol of 29 June 2006, in force since 1 June 2007.

39 Arts. 10(2)(b) and 11(7) as they read after the amendment by the protocol of 29 June 2006, in force since 1 June 2007.

40 It appears that the Federal Administrative Court arrived at this conclusion from a Swiss perspective in a case decided in 2008. Federal Administrative Court, *A GmbH*, 30 October 2008, A-2163/2007. This point is made by Franz Wassermeyer from the German perspective (notably the so-called

clarifies that only the true beneficiary has access to treaty benefits, but not an interposed fiduciary.[41] There is also a reference to article 4(6)(a) of the 1966 France DTC. The Federal Tax Administration points out that article 4(11) entitles a contracting state to apply domestic anti-avoidance measures to a tax treaty only if their application is not restricted by the obligations created by the treaty.[42] It appears that this position is consistent with the Swiss observations to the 2003 OECD commentary on article 1 and the interpretative approach as argued in this report. Consequently, this report takes the same position that article 4(11) has to be construed in the way that the contracting states merely included the treaty requirement of beneficial ownership in the residence article.

A further attribution rule in respect of beneficial ownership is included in paragraph I(ii) (Entitlement to treaty benefits) of the 2006 protocol to the 1966 Spain DTC[43] that is applicable in addition to the beneficial ownership requirements in articles 10(2)(a)[44] and 11(3)[45] of the 1966 Spain DTC. It is stated that the benefits under the treaty are not granted to a person which is not the beneficial owner of the items of income derived from the other contracting state or items of capital situated therein. This means that the beneficial ownership requirement is also applicable to article 12. Furthermore, similarly to the attribution rules in articles 4(6)(a) of the 1966 France DTC, 4(5)(a) of the 1976 Italy DTC and 4(4)(1) of the 1978 Belgium DTC, the beneficial ownership requirement is applicable to all treaty benefits provided by the 1966 Spain DTC.

Conclusively, these attribution rules do not refer to domestic attribution rules. From a narrow reading of the treaty term "beneficial ownership" as argued elsewhere in this report, this means that these attribution rules have only declaratory significance under tax treaties. Arguably, a person who is resident of a contracting state and sells shares in a foreign company in the capacity of agent or nominee has no access to the treaty benefits of a treaty provision that corresponds to article 13(5) of the OECD model irrespective of whether the capital gains or the residence articles include an attribution rule in respect of beneficial ownership.

2.4.2. Conduit companies

On the request of Colombia, anti-conduit measures were included in the tax treaty, but finally in a less far-reaching version.[46] The new measures as agreed with Colombia and France are quite similar and basically relate to those included in the

cont.

Zurechnungstheorie). Franz Wassermeyer, loose-leaf, para. 228 to art. 4 Germany DTC. However, it is highly questionable whether the German doctrine to which the court refers is applicable to the tax treaty from a Swiss tax perspective. See also the leading US case *Aiken Inc.* v. *Commissioner*, 56 TC 925 (1971).

41 Technical explanations to the 1971 Germany DTC, BBl 1971 1436.

42 Federal Tax Administration, 7 February 1989, in Meier *et al.*, *op. cit.*, B 4.11 no. 37.

43 Para. (ii) as it reads after the amendment by the protocol of 29 June 2006, in force since 1 June 2007.

44 Art. 10(2)(a) as it reads after the amendment by the protocol of 29 June 2006, in force since 1 June 2007.

45 Art. 11(3) as it reads after the amendment by the protocol of 29 June 2006, in force since 1 June 2007.

46 Technical explanations to the 2008 Colombia DTC, BBl 2008 4473.

1977 UK DTC and 2008 Chile DTC. However, the latter are applicable only to the dividend, interest, royalties and other income articles.

Articles 21 of the 2008 Colombia DTC and 14 of the 1966 France DTC (as it reads after the amendment on 28 August 2009)[47] include a general anti-conduit measure. If a company resident in a contracting state receives income arising in the other contracting state and passes on at least 50 per cent, directly or indirectly, at any time or any form, to one or several other persons who is or are not resident in the other contracting state, this item of income is excluded from treaty benefits. This means that the anti-conduit measure is not only applicable to the dividend, interest and royalties articles, but to all treaty benefits.

This anti-avoidance measure also takes account of bona fide situations. The anti-conduit provision is not applicable if the company that claims treaty relief shows that the main purpose of the business relationship was not obtaining benefits under the tax treaty. This bona fide situation is deemed to be present if the item of income is passed on by the company resident in a contracting state to one or several not related persons, or it would have been treaty equal or more favourable under a tax treaty if it directly went to the person or persons to whom it was passed on.

Article 14(3) of the 1966 France DTC clarifies that this anti-avoidance measure is not applicable if a taxpayer asks for treaty benefits under article 11(2)(b)(i). This means that article 11(2)(b)(i) is subject to the anti-avoidance measures in article 11(2)(b)(ii) and (iii) that have to be considered as *lex specialis* in relation to Article 14(3).

2.4.3. Arranged or maintained relationships

The old 1951 US DTC, the 1951 Netherlands DTC[48] and the 1977 UK DTC (as it read before the cancellation on 26 June 2007)[49] include specific arranged or maintained provisions. Article 9(2)(a)(i) of the 1951 Netherlands DTC states that the total amount of dividend withholding tax is refunded where the recipient of the dividends is a company which owns at least 25 per cent of the capital of the company paying the dividend, provided that the relationship between the two corporations has not been arranged or is maintained primarily with the intention of securing such treaty relief. This treaty provision was at issue in a case decided by the Federal Supreme Court in 1984.[50] The court concluded that the claimant had to be regarded as a domicile company and, therefore, refused treaty relief under article 9(2)(a)(i) on grounds that the relationship between the claimant and the distributing Swiss company was primarily arranged or maintained with the intention of securing the entire tax refund.

47 Art. 14 as it reads after the amendment by the Supplementary Agreement of 28 August 2009, not yet entered into force.

48 Art. 9(2)(a)(i) as it reads after the amendment by the Agreement of 22 June 1966, in force since 22 December 1966.

49 Art. 10(3)(d)(i) as it reads after the amendment by the protocol of 5 March 1981, in force since 10 May 1982, and before the cancellation by the protocol of 26 June 2007, in force since 22 December 2008.

50 Federal Supreme Court, *X International BV*, 9 November 1984, BGE 110 Ib 287.

The US treaty provision was at issue in a case decided by the Federal Supreme Court in 1996.[51] Article VI(1) of the old 1951 US DTC provided for a residual treaty rate of 15 per cent. Article VI(2) provided for a treaty rate of 5 per cent if the shareholder was a corporation controlling, directly or indirectly, at least 95 per cent of the entire voting power in the corporation paying the dividend. The treaty provision stated that this treaty relief was not applied if the relationship of the two corporations had been arranged or was maintained primarily with the intention of securing the reduced rate. The court refused treaty relief under article VI(2) on grounds that the share transfer between US companies within the group was primarily arranged with the intention of securing the reduced treaty rate.

2.4.4. Beneficial ownership

The concept of beneficial ownership was introduced in Swiss treaty law by article VI(3) and (4) of the old 1954 UK DTC. Since the 1970s, the concept of beneficial ownership has been regularly adopted in Swiss tax treaties. In the Denmark case, the Federal Commission of Appeals in Tax Matters held that the beneficial ownership requirement was implicitly included in Swiss tax treaties.[52] This reasoning is consistent with the prevailing view in the Swiss doctrine and the point made elsewhere in this report.[53]

The interpretations of the treaty terms "beneficial ownership" and "beneficiary" were at issue in the Federal Commission of Appeals in Tax Matters' decision of 28 February 2001.[54] According to article 10(2)(a)(i) of the 1993 Luxembourg DTC, the federal withholding tax is 5 per cent if the "beneficial owner" is a company holding directly at least 25 per cent of the capital of the Swiss company paying the dividend. The federal withholding tax is nil according to article 10(2)(b) if the "beneficiary (*bénéficiare*)" is a company holding directly for an uninterrupted period of two years preceding the payment of the dividends at least 25 per cent of the capital of the company paying the dividend. The commission concluded that the administration was right to demand the information directly from the claimant on the grounds of article 48(1) of the 1965 Federal Withholding Tax Act. The commission interpreted the treaty terms "beneficial ownership" and "beneficiary" autonomously and refused both partial and full treaty relief from Swiss withholding taxes under articles 10(2)(a)(i) and 10(2)(b) respectively on grounds of article 21(2) of the 1965 Federal Withholding Tax Act as well as the reasoning that the claimant resident in Luxembourg was regarded as a conduit company that was neither the beneficiary nor the beneficial owner.

The commission's reasoning in respect of the application of article 21(2) to a tax treaty is, however, highly questionable. The point made elsewhere in this report is that article 21(2) is only applicable to the domestic context and, therefore, has no international effect in the treaty context.

Then, the commission's reasoning in respect of the non-taxation of the dividends in the other contracting state is also highly questionable. Similarly, the

51 Federal Supreme Court, *S AG*, 16 August 1996, 1997/98, pp. 406–416.

52 Federal Commission of Appeals in Tax Matters, *X Holding ApS*, 3 March 2005, SRK 2003-159.

53 See René Matteotti, 2009, at p. 229 *et seq.*

54 Federal Commission of Appeal in Tax Matters, *V SA*, 28 February 2001, VPB 65.86 = *International Tax Law Reports* 4 (2002) pp. 191–214.

commission held in the Denmark case four years later that the interpretation of the term "beneficial ownership" had to be clarified in such a way that its interpretation had to take account of where the net income was ultimately subject to tax.[55] The Federal Supreme Court based its decision in the first 1962 Abuse Decree case on a similar reasoning in respect of double non-taxation, but dropped it twenty years later in the second case. In contrast to the commission's reasoning, it is submitted that the treaty term "beneficial ownership" does not implicitly include a subject to tax requirement. The purpose of a tax treaty is not to permit persons who are not residents of one or both contracting states to benefit from treaty advantages by interposing letterbox companies. Arguably, it does not matter whether an interposed letterbox company passes on the dividend income either as an expense or as a dividend to a person not entitled to the treaty.

In view of the Federal Supreme Court's 2005 ruling in the Denmark case, it appears that this case would have the same outcome, but based on different reasoning. The lack of substance (offices, employees, substantive business operations, etc.) of the claimant in the other contracting state is not a question of beneficial ownership. Arguably, treaty shopping by interposing letterbox companies falls into the scope of treaty abuse that is prohibited by the principle of prohibition of abuse of rights in article 9 of the 1999 Federal Constitution.

2.4.5. Conduit companies

Anti-conduit measures in respect of dividends, interest, royalties and other income were recently introduced at the request of the UK in articles 3(1)(l), 10(6), 11(7), 12(5) and 21(4) of the 1977 UK DTC.[56] At the request of Chile, anti-conduit measures were also included in paragraph 5 of articles 10, 11 and 12 of the 2008 protocol to the 2008 Chile DTC,[57] but finally in a less far-reaching version.[58] The provisions in the 2008 Chile DTC are similar and relate to those in the 1977 UK DTC.

The term "conduit arrangement" is defined as a transaction or series of transactions which is structured in such a way that a resident of a contracting state entitled to the benefits of the tax treaty receives an item of income arising in the other contracting state but that resident pays, directly or indirectly, all or substantially all of that income (at any time or in any form) to another person who is not a resident of either contracting state and who, if it received that item of income directly from the other contracting state, would not be entitled under a tax treaty between the state in which that other person is resident and the contracting state in which the income arises, or otherwise, to benefits with respect to that item of income which are similar to, or more favourable than, those available under this treaty to a resident of a contracting state and the main purpose of such structuring is obtaining benefits under the tax treaty. Conclusively, this anti-conduit measure includes an objective test (the conduit test) and a motive test (the main purpose test).

55 Federal Commission of Appeals in Tax Matters, *X Holding ApS*, 3 March 2005, SRK 2003-159.
56 Arts. 3(1)(l), 10(6), 11(7), 12(5) and 21(4) as they read after the amendment by the protocol of 26 June 2007, in force since 22 December 2008.
57 Para. 5 of the protocol to the 2008 Chile DTC, not yet entered into force, BBl 2008 8871.
58 Technical explanations to the 2008 Chile DTC, BBl 2008 8866.

It appears that the new anti-conduit measure in the 1977 UK DTC relates to the UK treaty anti-conduit measures, for example articles (3)(1)(n), 7(5), 10(9), 11(7), 12(5) and 22(4) of the 2001 UK–USA DTC that provides for a quite similar definition of the term "conduit arrangement". The motive test in article (3)(1)(n) of the 2001 UK–USA DTC also refers to the main purpose or one of the main purposes respectively.

2.4.6. Look-through

On the request of other contracting states, Switzerland has recently adopted also entity based look-through provisions in its tax treaties. An early look-through treaty measure is included in the previous version of article 11(2)(b)(ii) of the 1966 France DTC (as its reads after the amendment on 22 July 1997, but before the amendment on 28 August 2009).[59] It states that the elimination of source taxation of inter-company dividends in article 11(2)(b)(i) does not apply if the beneficial owner of the dividends is a company which is a resident of a contracting state in which one or more persons who are not residents of that state or of a EC Member State, and has a direct or indirect majority interest in the form of an equity holding or in any other form, and if neither the company paying the dividends nor the company receiving them has its capital represented by listed shares on a regulated stock exchange. It appears that the elimination of withholding taxation of inter-company dividends relates to the EC Parent–Subsidiary Directive.

This look-through provision in article 11(2)(b)(ii) of the 1966 France DTC has recently been amended and separated into two provisions: article 11(2)(b)(ii) and (iii) (as it read after the amendment on 28 August 2009).[60] Paragraph (ii) states that the elimination of source taxation of inter-company dividends in article 11(2)(b)(i) does not apply if the distributed dividends benefit a legal entity that is controlled directly or indirectly by persons that are not resident of either contracting state unless the legal entity shows that it was not the main purpose of that shareholding to obtain entitlement to the tax relief. The bona fide clause of the stock exchange test of the previous version of article 11(2)(b)(ii) has been replaced by a motive test ("the main purpose"). The motive test is again more stringent than the one in the guiding principle in paragraph 9(5) of the 2003 OECD commentary on article 1 ("a main purpose") and is consistent with Swiss tax treaty law, in particular with article 3(1)(l) of the 1977 UK DTC[61] and paragraph 5 to articles 10, 11 and 12 of the 2008 protocol to the 2008 Chile DTC. Paragraph (iii) of article 11(2)(b) is applicable in relation to article 15 of the Switzerland–EC Savings Tax Agreement.

Paragraph II to article 10(2)(b) of the 2006 protocol to the 1996 Spain DTC[62] states that the elimination of source taxation of inter-company dividends in article

59 Art. 11(2)(b)(ii) as its reads after the amendment by the Supplementary Agreement of 22 July 1997, in force since 1 August 1998, and before the amendment by art. 1 of the Supplementary Agreement of 28 August 2009, not yet entered into force.

60 Art. 11(2)(b)(ii) and (iii) as they read after the amendment by the Supplementary Agreement of 28 August 2009, not yet entered into force.

61 Arts. 3(1)(l), 10(6), 11(7), 12(5) and 21(4) as they read after the amendment by the protocol of 26 June 2007, in force since 22 December 2008.

62 Para. II of the protocol of 29 June 2006, in force since 1 June 2007.

10(2)(b) does not apply if a company resident of a contracting state benefits from the total relief of the withholding tax regarding dividends from the other contracting state, where the majority of its shares is held principally, directly or indirectly by persons that are not resident of a contracting state or of an EC Member State, unless the company receiving the dividends (a) carries on directly a real business activity in relation to the business of the company paying the dividends; or (b) has as a main purpose the control and management of the company paying the dividends through sufficient material and human means; or (c) proves that it has been constituted for valid economic reasons and not just in order to benefit from elimination of source taxation of inter-company dividends.

2.4.7. Subject to tax (dividends, interest and royalties)

Paragraph 5 to articles 10 and 11 of the 1996 protocol to the 1996 Venezuela DTC includes a subject to tax clause according to which Switzerland may tax Swiss source dividends and interest at the statutory withholding tax rate if such income according to the law in Venezuela is considered to be foreign income and for that reason is exempt from tax in Venezuela. This anti-avoidance provision provides for several bona fide situations.

Article 12(7) of the 1966 Spain DTC[63] requires for the exemption from source taxation of inter-company royalties that the receiving company is subject to and not exempt from taxes in particular on royalties. It appears that this requirement again relates to article 15 of the 2004 Switzerland–EC Savings Tax Agreement which in turn relates to the EC Interest and Royalties Directive.

2.4.8. Treaty provisions similar to the 1962 Decree

Article 14 of the 1966 France DTC (as it read before the amendment on 28 August 2009),[64] article 23 of the 1971 Germany DTC (as it read before the amendment on 12 March 2002),[65] article 23 of the 1976 Italy DTC, and article 22 of the 1978 Belgium DTC provide for specific anti-avoidance provisions that are similar and relate to the 1962 Decree. These specific anti-avoidance provisions have to be considered as *lex specialis* in relation to the 1962 Decree and, thus, are not amended by the 1999 circular. As mentioned above, these provisions also include specific treaty provisions allowing the application of more far-reaching domestic anti-avoidance provisions in the 1962 Decree.

These provisions include anti-avoidance measures in respect of thin capitalization, conduit companies, expenses, base companies, subject to tax and look-through. The scope of thin capitalization, conduit companies, expenses, and base companies is limited to treaty provisions that correspond to articles 10 to 12 of the OECD model. The scope of the subject to tax provisions is limited to treaty provisions that correspond to articles 10 and 12 and in the case of the treaty with Germany and also

63 Arts. 10(2)(b) and 11(7) as they read after the amendment by the protocol of 29 June 2006, in force since 1 June 2007.

64 Art. 14 as it read before the amendment by the Supplementary Agreement of 28 August 2009, not yet entered into force.

65 Art. 23(1) as it read before the cancellation by the protocol of 12 March 2002, in force until 23 March 2003.

to article 13(5). The scope of the look-through provision is limited to family foundations and to treaty provisions that correspond to articles 10 to 12 and in the case of the treaty with Germany again also to article 13(5).

2.4.9. Pensions

The revised article 18 of the 1977 UK DTC[66] includes an anti-avoidance provision according to which a lump-sum payment derived from a pension scheme established in a contracting state and beneficially owned by a resident of the other contracting state is taxable only in the first mentioned state.

The purpose of this measure is to counteract situations where individuals change their tax residence for the purpose of getting access to a more favourable domestic tax regime (e.g. no taxation of lump-sum payment derived from a pension scheme established in another state) in the other contracting state and obtaining treaty benefits at the same time (so-called pilot trick). Article 18 of the 1977 UK DTC allows Switzerland to apply its domestic withholding taxation rules in articles 95 and 96 of the 1990 Federal Income Tax Act to tax a lump-sum payment derived from a domestic pension scheme in cases where the taxpayer transferred his tax residence to the other contracting state before the lump-sum payment became due.

2.4.10. Limitation on benefits

Article 22 of the 1996 US DTC includes a complex limitation on benefits clause in accordance with the US tax treaty policy.[67] These measures prevail over those in the 1962 Decree according to the principle *lex specialis derogat legi generali*. The limitation on benefits clause restricts the personal scope of the tax treaty to residents that meet specific predetermined tests. As a consequence of the limitation on benefits clause, only qualifying residents have access to treaty benefits.

66 Art. 18(2) as it reads after the amendment by the protocol of 26 June 2007, in force since 22 December 2008.

67 Xavier Oberson and Howard R. Hull, 2006, at pp. 201 *et seq.*