SWITZERLAND/EUROPEAN UNION

Art. 15 of the Switzerland-EC Savings Tax Agreement: Measures Equivalent to Those in the EC Parent-Subsidiary and the Interest and Royalties Directives – A Swiss Perspective[1]

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Contents

1. INTRODUCTION

Switzerland's relations with the European Community (EC) are clearly "a special case". On 2 May 1992, Switzerland signed the Agreement on the European Economic Area (hereinafter: the EEA Agreement).[2] On 6 December 1992, however, the Swiss rejected the EEA Agreement in a referendum. Following this, Switzerland entered into bilateral negotiations with the EC and its Member States. On 21 June 1999, seven agreements, including the Agreement on the Free Movement of Persons[3] (hereinafter: the Free Movement Agreement), were signed. On 26 October 2004, nine additional agreements were signed, including the Switzerland-EC Savings Tax Agreement (*Zinsbesteuerungsabkommen*, ZBstA) and its accompanying Memorandum of Understanding (MoU).[4] The ZBstA entered into force on 1 July 2005.

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1. This article is an expanded version of a visiting lecture given at the Chartered Institute of Taxation, London, 21 June 2005 and a submitted LL. M. essay. The author is grateful to the *Freiwillige Akademische Gesellschaft*, Basle, for a grant in respect of the LL.M. (Tax) Programme at the Queen Mary School of Tax Law, University of London. The author is also grateful to Peter Reinarz, Tax Partner, Bär & Karrer, Zurich, for reviewing the manuscript.

2. The EEA Agreement, as amended by the Agreement of 14 October 2003, applies between the EC and its 25 Member States, on the one hand, and Iceland, Liechtenstein and Norway (the EEA-EFTA Member States), on the other. The current Member States of the Convention of 4 January 1960 establishing EFTA (hereinafter: the EFTA Convention) are Iceland, Liechtenstein, Norway, and Switzerland.

3. The Agreement of 21 June 1999 between the EC and its Member States, on the one hand, and the Swiss Confederation, on the other, on the Free Movement of Persons, Official Journal (EC), L 114, 30 April 2002, p. 6. On 26 October 2004, Switzerland signed the Protocol to the Free Movement Agreement that will extend the territorial scope of the original agreement to the new Member States that joined the European Union on 1 May 2004 (Council Doc. 12582/04, 22 October 2004). On 25 September 2005, the Swiss approved the extension in a referendum. As a result of the Agreement of 21 June 2001, which amended the EFTA Convention and which entered into force on 1 June 2002, Switzerland has concluded similar provisions on the free movement of persons with Iceland, Liechtenstein, and Norway.

4. The Agreement of 26 October 2004 between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments and the accompanying Memorandum of Understanding, Official Journal (EC), L 385, 29 December 2004, p. 30.

Under the ZBstA, Switzerland has agreed to institute measures equivalent to those in the Savings Directive.[5] These arrangements are a form of international cooperation to safeguard a foreign tax base by way of precautionary measures, such as tax retention (hereinafter: the EC savings tax retention), the reporting of interest payments and the exchange of information.[6] The EC savings tax retention is neither a Swiss-source tax nor an income tax.[7] Instead, the Swiss portion of the EC savings tax retention is remuneration for Swiss cooperation with the EC and its Member States.[8] In return for Switzerland's implementation of these arrangements, Art. 15 of the ZBstA provides for measures equivalent to those in the EC Parent-Subsidiary and the Interest and Royalties Directives.[9] In contrast to the EC savings tax retention, Art. 15 of the ZBstA is a matter of tax law. Finally, under the MoU, Switzerland will enter into bilateral negotiations with each Member State with a view to including in the tax treaties with the Member States an exchange of information clause regarding "tax fraud" or "the like" for income not subject to the ZBstA, but, instead, covered by the tax treaties.[10] This Swiss obligation is in line with the new Swiss treaty policy.[11]

This article first focuses on the Swiss international tax law in question, in particular, Federal withholding tax (*Verrechnungssteuer*) and the tax treaties with the Member States (see 2.). The article then analyses the interpretation and application of Art. 15 of the ZBstA and its effect on Swiss international tax law (see 3.). Specifically, it connects that part of the Swiss international tax law in question to Art. 15 of the ZBstA. This is important as domestic anti-abuse measures are one of the key issues regarding the interpretation and application of tax treaties and Art. 15 of the ZBstA.[12]

2. SWISS INTERNATIONAL TAX LAW IN QUESTION

2.1. Federal withholding tax

2.1.1. Taxable investment income

Under the Federal Anticipatory Tax Act of 13 October 1965 (*Bundesgesetz über die Verrechnungssteuer*, VStG), Switzerland levies a withholding tax at source on the gross amount of taxable investment income. Taxable investment income includes (1) interest from bonds and similar debt instruments issued by domestic persons, (2) interest on domestic bank deposits and (3) dividends and liquidation distributions from shares issued by domestic corporations, limited liability companies and cooperatives. The tax rate is 35%. Interest on intercompany loans is generally not subject to Federal withholding tax, unless specified requirements are met, under which a loan (or a series of loans) is classified as a bond (the 10/20 non-bank creditors test) or domestic bank deposit for Federal withholding tax purposes.[13] Royalties and management fees are not subject to Federal withholding tax.

2.1.2. Tax relief

A resident person may, in principle, be entitled to a tax relief if the individual or legal person is the beneficiary (*Nutzungsberechtigter*) of the underlying asset.[14] From 1 January 2001, relief at source applies to intercompany cash dividend payments between domestic companies, provided that the recipient company has a direct holding of at least 20% in the capital of the distributing company.[15]

A non-resident person is entitled to a full or partial tax relief if it has access to the benefits of a tax treaty or other agreement, for example the ZBstA. From 1 January 2005, Switzerland has amended its relief procedure for cross-border intercompany dividends under a tax treaty or an agreement.[16] Under the new regime, relief at source applies if the treaty threshold for intercompany dividends is met or, in the absence of a treaty provision on intercompany dividends, the recipient foreign company has a direct holding of at least 20% of the capital in the distributing domestic company.[17] The new relief-at-source procedure only applies to intercompany dividends.

2.1.3. General anti-abuse provision

Art. 21(2) of the VStG provides for a general anti-abuse measure. With regard to its interpretation, the Swiss Federal Supreme Court has referred to the long-standing judicial anti-abuse doctrine, under which the following three cumulative tests must be met:[18]

5. Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments, Official Journal (EC), L 157, 26 June 2003, p. 38. Under Art. 10 of the ZBstA, Switzerland has agreed to exchange of information on "tax fraud" or "the like" in respect of income covered by the ZBstA, whereby information will be exchanged under the procedures in the tax treaties between Switzerland and the Member States.
6. Swiss Federal Government, Technical Explanations of 1 October 2004, Para. 6.3.3.
7. Id., Para. 6.3.3. See also Xavier Oberson, "Agreement between Switzerland and the European Union on the Taxation of Savings – A balanced '*Compromis Helvétique*'", 59 *Bulletin for International Fiscal Documentation* 3 (2005), p. 109.
8. Id.
9. 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, Official Journal (EC), L 225, 22 September 1990, p. 6 and Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments between associated companies of different Member States, Official Journal (EC), L 157, 26 June 2003, p. 49.
10. Art. 2 MoU.
11. See Para. 24 of the OECD Commentary on Art. 26, as it read on 15 July 2005.
12. Following the terminology in Para. 9.2 of the OECD Commentary on Art. 1, and Art. 1(2) of the EC Parent-Subsidiary and Art. 5 of the Interest and Royalties Directives, this article uses the term "tax abuse" rather than "tax avoidance". The article does not consider fiscal fraud (*Abgabebetrug*) and tax evasion (*Steuerhinterziehung*), which are different from tax abuse.
13. FTA Notices S-02.122.1 on bonds and S-02.122.2 on bank deposits of April 1999. See Daniel Lehmann, "Tax Issues Associated with Trading in Syndicated Loans against Swiss Borrowers", 6 *Derivatives & Financial Instruments* 4 (2004), pp. 163-169.
14. Art. 21(1) of the VStG links the beneficiary requirement to the underlying asset from which the taxable income is derived.
15. Art. 26a(1) of the Regulation of 19 December 1966 to the Federal Anticipatory Tax Act of 13 October 1965.
16. See also Art. 3 of the Regulation of 30 April 2003 to the Germany–Switzerland tax treaty and Art. 4 of the Regulation of 15 June 1998 to the Switzerland–US tax treaty.
17. Art. 2 and Art. 3(3) of the Regulation on tax relief for substantial participations of 22 December 2004 and FTA Circular No. 6 on international reporting procedure of 22 December 2004. See also FTA Circular No. 10 on international reporting procedure under Art. 15(1) of the ZBstA of 15 July 2005 (addition to Circular No. 6 of 22 December 2004).
18. See, for example, Federal Commission, 28 February 2001, Para. 7(b)(cc)(bbb), 57 *SteuerRevue* 1 (2002), pp. 30-39, unofficial translation in *International Tax Law Reports* 4 (2002), pp. 191-214.

(1) 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);
(2) the choice was made abusively with the intention of saving tax (the subjective element); and
(3) the method chosen would effectively lead to a substantial reduction in tax (the factual element).

The Swiss judicial anti-abuse doctrine and, in particular, its subjective element, relates to the German tax scholar Becker and the German "*Reichsabgabenordnung*" of 13 December 1919.[19]

2.2. Tax treaties with Member States

2.2.1. Intercompany dividends and interest

Switzerland has concluded tax treaties with all the Member States of the EC, except Cyprus and Malta.[20] Some of these tax treaties provide for a zero rate in respect of Swiss-source intercompany dividends, including those with Austria (a direct holding of at least 20% of the capital), Denmark (no minimum holding requirement), France (a direct or indirect holding of at least 10% of the capital), Germany (a direct holding of at least 20% of the capital), Luxembourg (a direct holding of at least 25% of the capital), the Netherlands (a holding of at least 25% of the capital) and Sweden (a direct holding of at least 25% of the capital).[21] An amendment to the Norway–Switzerland tax treaty (a holding of at least 20% of the capital) was signed on 12 April 2005.[22] Some tax treaties also provide for a zero rate in respect of Federal withholding tax on Swiss-source interest.[23]

2.2.2. Indirect domestic tax credit

Under some tax treaties concluded by states that have an imputation system, a non-resident individual or corporate shareholder is granted full or partial relief in respect of the underlying domestic corporation tax. Van Raad refers to this, from the point of view of the imputation system that grants the relief, as an "indirect domestic tax credit".[24] This system is found in Art. 10(3)(b) and (c) of the Switzerland–UK tax treaty, under which the UK tax credit is fully or partially extended to Swiss resident individual and corporate shareholders. For an individual shareholder, this modifies the Swiss classical system in an inbound context (vertical integration between the corporate and the individual shareholder levels in the cross-border context). For a corporate shareholder, this mitigates the economic multiple taxation of corporate profits and, therefore, has a similar effect as the unilateral indirect foreign tax credit method that is also provided for in Art. 4(1), second indent of the EC Parent-Subsidiary Directive (horizontal integration at the corporate shareholder level in the cross-border context).

It should be noted that the United Kingdom does not levy a withholding tax on outbound dividends.[25] Under Art. 10(3)(a)(ii) and (iii) of the Switzerland–UK tax treaty, the United Kingdom may charge a tax at a rate not exceeding 15% for a Swiss resident individual shareholder or 5% for a Swiss resident corporate shareholder on the aggregate of the amount of the dividends and the amount of the UK tax credit.[26] The UK tax credit is set off against UK withholding tax. Swiss resident shareholders are entitled to a foreign tax credit for the remaining UK tax.[27]

2.2.3. Unilateral anti-abuse measures

2.2.3.1. *2003 Revision of the OECD Commentary*

The interpretation of tax treaties is governed by Art. 31 to Art. 33 of the Vienna Convention of 23 May 1969 on the Law of Treaties (hereinafter: the Vienna Convention).[28] The legal basis for reference to the Commentary to the OECD Model Convention (hereinafter: the OECD Commentary) is far from clear. Nevertheless, this is a useful aid to the interpretation and application of tax treaties. It should, however, be noted that the OECD Committee on Fiscal Affairs (CFA) tends to accept the position of tax administrations, as most of the CFA's work is undertaken by government officials. By accepting a change to the OECD Commentary without observation or reservation, a tax administration may create a legitimate expectation that this is how it interprets and applies tax treaties.[29]

The 2003 Revision of the OECD Commentary has taken a different approach to tax abuse and tax treaties and, in particular, has clarified the relationship between domestic anti-abuse provisions and tax treaties.[30] The main changes were added in the OECD

19. Enno Becker emphasized the subjective element: "*Der Steuerpflichtige muss die Absicht haben, die Steuer zu umgehen*" ("The taxpayer must have the *intention* to avoid the tax.") (emphasis added), Enno Becker, *Die Reichsabgabenordnung vom 13. Dezember 1919*, fifth edition (Berlin: Carl Heymanns Verlag, 1926), Sec. 5, Para. 5(b). See the landmark case of the Federal Supreme Court (1 December 1933, *Entscheidungen des Schweizerischen Bundesgerichts* (BGE) 59 I 284, Para. 8(b). See also Peter Böckli, "Steuerumgehung: Qualifikation gegenläufiger Rechtsgeschäfte und normative Gegenprobe", in Ernst Höhn and Klaus Vallender (eds.), *Steuerrecht im Rechtsstaat, Festschrift für Prof. Dr. Francis Cagianut zum 65. Geburtstag* (Bern: Haupt, 1990), p. 290.
20. Switzerland signed an agreement on 30 March 1987 with Malta on the taxation of shipping and air transport.
21. Art. 10(2) of the Austria–Switzerland, Art. 10(1) of the Denmark–Switzerland, Art. 11(2)(b)(i) of the France–Switzerland, Art. 10(3) of the Germany–Switzerland, Art. 10(2)(b) of the Luxembourg–Switzerland, Art. 9(2)(a)(i) of the Netherlands–Switzerland and Art. 10(2) of the Sweden–Switzerland tax treaties.
22. Art. 10(2) of the Norway–Switzerland tax treaty, as amended on 12 April 2005.
23. See, for example, Art. 11(1) of the Austria–Switzerland, Art. 11(1) of the Czech Republic–Switzerland, Art. 11(1) of the Denmark–Switzerland, Art. 11(1) of the Finland–Switzerland, Art. 12(1) of the France–Switzerland, Art. 11(1) of the Germany–Switzerland, Art. 11(1) of the Iceland–Switzerland, Art. 11(1) of the Ireland–Switzerland, Art. 11(1) of the Norway–Switzerland and Art. 10(1) of the Switzerland–UK tax treaties.
24. Kees van Raad, "Observations on Integration of Corporation and Individual Income Taxes within the European Community", *Connecticut Journal of International Law* (1994), p. 764. See also Para. 48 of the OECD Commentary on Art. 10(5).
25. Jonathan S. Schwarz, *Tax Treaties: United Kingdom Law and Practice* (London: Sweet & Maxwell, 2004), pp. 233 and 237.
26. Id., p. 10 et seq. Sec. 788(3)(d) of the Income and Corporation Taxes Act 1988 (ICTA) authorizes tax treaties to confer on non-UK residents the right to a tax credit under Sec. 231 of the ICTA.
27. Art. 1 of the Regulation on the foreign tax credit of 22 August 1967. See Para. II of the Annex to Art. 5 of the Regulation on the foreign tax credit of 6 December 1976 and FTA Notice R-GB-M on tax relief for UK-source income of 2003.
28. See Philip Baker, *Double Taxation Conventions, A Manual on the OECD Model Tax Convention on Income and Capital* (London: Sweet & Maxwell, 2004), loose-leaf, Introductory Topics, Para. E.01 et seq.
29. Id., Introductory Topics, Para. E.16.
30. Brian Arnold, "Tax Treaties and Tax Avoidance: The 2003 Revisions to the Commentary to the OECD Model", 58 *Bulletin for International*

Commentary on Art. 1. Para. 7 states that it is a purpose of tax treaties to prevent tax avoidance and tax evasion. Switzerland is the only Member country of the OECD that has entered an observation under which it is not the purpose of tax treaties to prevent tax avoidance or tax evasion.[31]

The revised OECD Commentary on Art. 1 deals with the following three issues: (1) the relationship between domestic anti-abuse provisions and tax treaties, (2) conduit companies, i.e. treaty shopping, and (3) other forms of abuse of tax treaties. Para. 9.2 states that an abuse of the provisions of a tax treaty could also be characterized as an abuse of the provisions of domestic law under which taxes are levied. Under Paras. 9.2 and 22.1, to the extent that these anti-abuse rules are part of the basic domestic rules established by domestic tax law for determining which facts give rise to a tax liability, the anti-abuse rules are not addressed in tax treaties and, therefore, these rules are unaffected by tax treaties.[32] Accordingly, there is generally no conflict between domestic anti-abuse rules and the provisions of tax treaties. Para. 22.1 addresses abuses of tax treaties other than treaty shopping, for example the use of base companies. With regard to Para. 22.1, Switzerland has entered an observation under which it believes that domestic tax rules on the abuse of tax treaties must conform to the general provisions of tax treaties, especially if the tax treaty includes provisions intended to prevent its abuse.[33] Switzerland has not entered an equivalent observation regarding Para. 9.2.

On 28 June 2002, the French *Conseil d'Etat* stated in the *Société Schneider Electric* case that the French controlled foreign companies (CFC) legislation is incompatible with the provisions of the France–Switzerland tax treaty.[34] Under Para. 23 of the OECD Commentary on Art. 1 as revised in 2003, CFC legislation is, however, generally not contrary to the provisions of the OECD Model Convention (hereinafter: the OECD Model).[35] With regard to Para. 23, Switzerland has entered an observation, under which Switzerland considers that such legislation may, depending on the relevant concept, be contrary to the spirit of Art. 7 of the OECD Model.[36]

Apparently, the CFA tends towards the introduction of a common concept of tax abuse. Under Para. 8, tax abuse is apparently identified with "artificial legal constructions" intended to secure the benefits provided for in both domestic tax and treaty law.[37] Para. 9.5 provides for a two-step guiding principle, under which:

> the benefits of a double tax treaty should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions.

The object and purpose test is similar to the abuse-of-rights test that was suggested by the Advocate General of the European Court of Justice (ECJ) in the *Halifax* case (see 3.6.2.3.). The OECD Commentary notes that it should not be lightly assumed that a taxpayer has entered into this type of abusive transaction. Considering Para. 3 of the Introduction, under which the main purpose of the OECD Model is the avoidance of international juridical double taxation, in the author's view, the suggested object and purpose test should be linked to potential rather than actual double taxation.[38] A tax treaty may, however, provide for a subject-to-tax clause or another clause that is similar to the clauses in Para. 13 et seq. of the OECD Commentary on Art. 1 addressing harmful preferential tax regimes.

2.2.3.2. *"Old reserves" doctrine*

Before the 2003 Revision of the OECD Commentary, the Swiss Federal Tax Administration (FTA) took the view that all Swiss tax treaties were subject to at least an implicit reservation, under which the states are not limited by tax treaties in their ability to adopt domestic measures designed to prevent abuses of tax treaties.[39] Para. 7 of the OECD Commentary on Art. 1, before the 2003 Revision, stated:

> Such States will then wish, in their bilateral double taxation conventions, to preserve the application of provisions of this kind [of anti-abuse measures] contained in their domestic laws.

As discussed in 2.2.4., there is, however, a decision of the Federal Commission of Appeal in Tax Matters (hereinafter: the Federal Commission) of 28 February 2001 regarding Art. 10(2)(a)(i) of the Luxembourg–Switzerland tax treaty, in which it applied Art. 21(2) of the VStG, as it took account of the specific context in which Art. 10(2)(a)(i) was adopted rather than being an implicit reservation.

The FTA has developed a specific anti-abuse concept in the context of transfer of shares in Swiss resident companies with undistributed earnings.[40] The base case is a transfer of these Swiss shares by a non-resident shareholder to a resident or non-resident acquirer who, under Swiss domestic law or an applicable tax treaty, would be in a better position regarding non-refundable Federal withholding taxes on dividends than the previous selling shareholder. The FTA would treat this form of share transfer as an abuse, especially if the transfer occurred between related parties and, in

Fiscal Documentation 6 (2004), pp. 244-260; Baker, note 28, Introductory Topics, Para. F.03 et seq., Para. F.08 et seq. and Art. 1, Para. 1B.40 et seq.; Adolfo Martin Jimenez, "The 2003 Revision of the OECD Commentaries on the Improper Use of Tax Treaties: A Case for the Declining Effect of the OECD Commentaries?", 58 *Bulletin for International Fiscal Documentation* 1 (2004), pp. 17-30; and René Matteotti, "Interpretation of Tax Treaties and Domestic General Anti-Avoidance Rules – A Sceptical Look at the 2003 Update to the OECD Commentary", 33 *Intertax* 8/9 (2005), pp. 336-350.

31. Para. 27.9 of the OECD Commentary on Art. 1.
32. This statement was already in Para. 23 of the OECD Commentary on Art. 1 as it read before the 2003 Revision.
33. Para. 27.9 of the OECD Commentary on Art. 1.
34. *Conseil d'Etat*, 28 June 2002, *Société Schneider Electric*, unofficial translation in *International Tax Law Reports* 4 (2002), pp. 1077-1130.
35. See also Michael Lang, "CFC Regulations and Double Taxation Treaties", 57 *Bulletin for International Fiscal Documentation* 2 (2003), pp. 51-58.
36. Para. 27.9 of the OECD Commentary on Art. 1.
37. Para. 8 of the OECD Commentary on Art. 1.
38. See Arnold, note 30, p. 245 and Jimenez, note 30, p. 21 et seq.
39. Peter Reinarz, "Treaty Shopping and the Swiss Withholding Tax Trap", 41 *European Taxation* 11 (2001), p. 417 and Maja Bauer-Balmelli, "Die Steuerumgehung im Verrechnungssteuerrecht", *IFF Forum für Steuerrecht* 3 (2002), p. 175.
40. Reinarz, note 39, p. 416. See also Anita Burri, "Rückerstattung der Verrechnungssteuer bei internationalen Umstrukturierungen", *IFF Forum für Steuerrecht* 3 (2001), pp. 204-209 and Bauer-Balmelli, note 39, pp. 162-183.

some instances, even if the shares were transferred to an unrelated party. Accordingly, the FTA would deny the acquirer the "better" withholding tax relief up to the amount of undistributed, non-working reserves ("old reserves") on the transfer. It appears that the FTA has based its practice on the general anti-abuse provision of Art. 21(2) of the VStG. Recently, the FTA has narrowed the scope of the "old reserves" doctrine and clarified that it may be applied in the case of a share transfer resulting in lower residual treaty rate for the non-resident acquirer compared to the previous non-resident shareholder, but only if the transfer amounts to "tax abuse", i.e. particularly if the share transfer is mainly tax motivated and lacks significant business reasons.[41] As taxable investment income does not include the payment of the purchase price by the resident or non-resident acquirer to the previous non-resident shareholder (see 2.1.1.), it is doubtful if the "old reserves" doctrine can be derived from Art. 21(2) of the VStG.[42] In particular, as discussed in 2.2.5., there is the Federal Supreme Court decision of 16 August 1996 regarding Art. VI(2) of the old Switzerland–US tax treaty, in which the application of the "old reserves" doctrine based on Art. 21(2) of the VStG in the context of a group restructuring was refused. In the light of the 2003 Revision of the OECD Commentary, it is also doubtful whether or not the application of Art. 21(2) of the VStG is in line with treaty law.[43] A systematic interpretation suggests that Art. 21(2) of the VStG is not a domestic anti-abuse measure in the context of tax liability, but only in respect of tax relief.[44] In the author's view, the beneficial ownership concept of Art. 10 to Art. 12 of the OECD Model addresses the entitlement to tax relief and, therefore, as a matter of principle precludes the application of Art. 21(2) of the VStG to the extent that it goes beyond the treaty provisions. As discussed in 2.2.3.1., Switzerland has also entered an observation with regard to the application of domestic anti-abuse provisions, especially if the tax treaty includes provisions intended to prevent its abuse. As discussed in 3.6.3.4., it is also doubtful whether or not the "old reserves" doctrine complies with Art. 15 of the ZBstA within an EC law context.

2.2.3.3. *Federal Decree of 14 December 1962*

Under the Federal Decree of 14 December 1962 on measures against the improper use of tax treaties, treaty relief from foreign-source taxation cannot benefit persons not entitled to treaty benefits.[45] The Swiss unilateral anti-abuse provisions apply if a resident person claims treaty relief from foreign withholding taxes and, therefore, address inbound payments. The FTA issued guidelines in the Anti-abuse Circular of 1962, as updated by the 1999 Circular.[46] The 1999 Circular, as amended in December 2001, introduced more generous rules for a resident company to qualify for treaty relief. The Federal Decree of 14 December 1962 does not limit the application of specific anti-abuse provisions in tax treaties, such as those in Art. 22 of the Belgium–Switzerland, Art. 14 of the France–Switzerland and Art. 23 of the Italy–Switzerland tax treaties.[47] The limitation-on-benefits clause in Art. 22 of the Switzerland–US tax treaty, however, precludes the application of the Federal Decree of 14 December 1962.[48]

2.2.4. Bilateral beneficial ownership

Under FTA practice, the beneficial ownership concept is implicit in tax treaties and, therefore, applies even in the absence of a treaty provision.[49] The beneficial ownership requirement was introduced by the 2003 Revision in Art. 10 to Art. 12 of the OECD Model to clarify how these articles apply.[50] Beneficial ownership as a condition for treaty relief is referred to in, for example, Art. 10(2), Art. 11(2) and Art. 12(1) of the Luxembourg–Switzerland, and Art. 10(1) and (2), Art. 11(1) and Art. 12(1) of the Switzerland–US tax treaties. With regard to inbound payments, the beneficiary requirement is included in Art. 1(2)(a) of the Federal Decree of 14 December 1962.

Under Art. 10(2)(a)(i) of the Luxembourg–Switzerland tax treaty, intercompany dividends are subject to a lower 5% treaty rate if the beneficial owner (*bénéficiaire effectif*) is a company holding directly at least 25% of the capital in the paying company. Under Art. 10(2)(b) of the Luxembourg–Switzerland tax treaty, intercompany dividends are exempt in the source state if the beneficial owner (*bénéficiaire*) is a company holding, directly for an uninterrupted period of two years preceding the date of payment of those dividends, at least 25% of the capital in the company paying the dividends. The interpretation of this provision was an issue in the case decided on 28 February 2001 by the Federal Commission.[51] This involved a Luxembourg company established in 1995 by two UK companies. The Luxembourg company acquired all the capital in a Swiss company from a US resident shareholder. In 1996 and 1997, the Swiss company paid dividends to the Luxembourg company that were subject to Federal withholding tax at 35%. With regard to dividends paid in 1997, the Luxembourg company requested a full relief under Art. 10(2)(b) of the Luxembourg-Switzerland tax treaty. The limited information provided by the Luxembourg company showed that, in 1995, the holding in the Swiss company was its only significant asset and that all the income received had been paid out as unspecified interest and charges.

41. Andreas Kolb and Robert Waldburger, University of St. Gallen, 21 and 22 September 2005, Seminar No. 8 on Business Taxation: Modification of the "old reserves" doctrine, Handout, slide 2, p. 1 and slide 6, p. 3.
42. See also Böckli, note 19, p. 309.
43. According to FTA practice, a domestic parent company may be subject to Federal withholding tax if its foreign subsidiary company issues a loan under a finance arrangement guaranteed by the domestic parent company, whereby the proceeds are, directly or indirectly, repatriated to the domestic parent company. (See Swiss Bankers Association's Circular No. 6746 of 29 June 1993 and Lehmann, note 13, pp. 163-169.) This doctrine is derived from Art. 9(1), second sentence of the VStG, which defines the term "domestic person" and, therefore, from domestic tax law that states which facts give rise to a tax liability. Apparently, therefore, this doctrine does not conflict with treaty law according to the 2003 Revision of the OECD Commentary.
44. Id., p. 308 et seq.
45. See Para. 18 of the OECD Commentary on Art. 1.
46. Peter Reinarz, "Revised Swiss Anti-Treaty Shopping Rules", 53 *Bulletin for International Fiscal Documentation* 3 (1999), pp. 116-117.
47. FTA 1999 Circular on the Federal Decree of 14 December 1962, as amended in December 2001, Para. 5.
48. Id., Para. 5.
49. See Federal Commission, note 18, Para. 7(b)(aa)(bbb) and FTA Guidelines on Art. 15(1) of the ZBstA of 15 July 2005, Para. 10(a).
50. Para. 12 of the OECD Commentary on Art. 10(2), Para. 8 of the OECD Commentary on Art. 11(2) and Para. 4 of the OECD Commentary on Art. 12(1).
51. Federal Commission, note 18.

In interpreting Art. 10(2)(b) of the Luxembourg–Switzerland tax treaty, the Federal Commission applied Art. 31 of the Vienna Convention. With regard of the ordinary meaning of the term "*bénéficiaire*", the Federal Commission considered the 1986 OECD Report on the Use of Conduit Companies. It held that the beneficiary is the person who can actually benefit from a payment and not someone who receives it subject to an obligation to transfer it to a third person, i.e. the person who effectively receives a payment and can dispose of it. The Federal Commission also concluded that this definition overlaps with that of "*bénéficiaire effectif*", which envisages the person who profits economically from income, and does not apply to conduit companies. Taking into account the limited information provided, the Federal Commission held that, apparently, the Luxembourg company was manifestly only a conduit company that could not be considered to be the beneficiary of the dividends paid by the Swiss company. If the Luxembourg company had been willing to disclose the facts more fully, a fuller interpretation of the term "beneficial owner" would have been allowed.[52] With regard to the object and purpose of Art. 10(2)(b) of the Luxembourg–Switzerland tax treaty, the Federal Commission took into account the fact that tax treaties are primarily intended to avoid the international juridical double taxation of residents of a state. In this respect, it stated that this was to permit Switzerland, in its relations with Luxembourg, to benefit from the EC Parent-Subsidiary Directive. The Federal Commission referred to Art. 1(2) of the EC Parent-Subsidiary Directive and argued that Switzerland could apply domestic anti-abuse measures under Art. 10(2)(b) of the Luxembourg–Switzerland tax treaty and held that the Federal withholding tax relief appeared to be abusive under Art. 21(2) of the VStG. As discussed in 3.6.2.2., the ECJ, however, apparently only considers abuse to be present if the corporate structures are "wholly artificial arrangements". Finally, the Federal Commission stated that Federal withholding tax may not be fully refunded under Art. 10(2)(b) of the Luxembourg–Switzerland tax treaty and refused a partial relief under Art. 10(2)(a) of the tax treaty.

2.2.5. Bilateral anti-abuse measures

Specific measures against the improper use of tax treaties regarding dividends, interest and royalties are, for example, contained in Art. 22 of the Belgium–Switzerland, Art. 14 of the France–Switzerland and Art. 23 of the Italy–Switzerland tax treaties. Specific measures regarding dividends are, for example, included in Art. 11(2)(b)(ii) of the France–Switzerland, Art. 9(2)(a)(i) of the Netherlands–Switzerland and Art. 10(3)(d)(i) of the Switzerland–UK tax treaties, and were also provided for in Art. VI(2) of the old Switzerland–US tax treaty. The Switzerland–US tax treaty has a complex limitation-on-benefits clause in Art. 22 that also includes an EC/EEA/NAFTA test.[53]

The specific measure in Art. 9(2)(a)(i) of the Netherlands–Switzerland tax treaty provides for a general *bona fide* clause.[54] Intercompany dividends may not be taxed in the source state if the recipient is a company holding at least 25% of the capital in the distributing company. The association must, however, not have been established mainly with the intention of securing full treaty relief. The interpretation of this provision was an issue in the Federal Supreme Court's decision of 9 November 1984.[55] In this case, a Swiss company distributed a first, substantial dividend to its two shareholders on 20 June 1980. The shareholders were a Netherlands company holding approximately 75% and a US company around 25% of the capital in the Swiss company. The Netherlands company was owned by a Curaçao company, which, in turn, was owned by a Liechtenstein entity. The FTA agreed to a Federal withholding tax relief of 20%, reflecting the ordinary treaty rate of 15% in Art. 9(2)(a)(ii) of the Netherlands–Switzerland tax treaty. The FTA, however, argued that the association between the Swiss and the Netherlands company had been established mainly with the intention of securing full treaty relief and, therefore, refused to apply Art. 9(2)(a)(i) of the Netherlands–Switzerland tax treaty. The Federal Supreme Court upheld this. It also pointed out that it was unnecessary to refer to the long-standing Swiss judicial anti-abuse doctrine, as, under Art. 9(2)(a)(i) of the Netherlands–Switzerland tax treaty, only a subjective element regarding the taxpayer's intention is required.

The Federal Supreme Court primarily interpreted Art. 9(2)(a)(i) of the Netherlands–Switzerland tax treaty in the context in which the provision was applied. It pointed out that Art. 9(2)(a)(i) of the Netherlands–Switzerland tax treaty was a relic from when the exclusive taxing right for dividends was generally assigned to the recipient's residence state. At the time of the Federal Supreme Court's decision, zero withholding tax on intercompany dividends was not standard in Swiss treaty practice. Indeed, only the Denmark–Switzerland tax treaty assigned the exclusive taxing right for dividends to the recipient's residence state. This different context led the Federal Supreme Court to its somewhat strict interpretation and application of Art. 9(2)(a)(i) of the Netherlands–Switzerland tax treaty. Since then, a zero rate for intercompany dividends has become a more common Swiss treaty practice. This applies in the tax treaties Switzerland has concluded with several countries, including those with Austria, France, Germany, Luxembourg, Sweden and Norway, as noted in 2.2.1., and now in Art. 15 of the ZBstA in relation to all Member States. This decision is, therefore, now not really relevant.

A similar general *bona fide* clause was at issue in the Federal Supreme Court's case of 16 August 1996 regarding Art. VI(2) of the old Switzerland–US tax treaty.[56] This decision deals with transfers of shares in a Swiss company within a US group of companies. On 1 January 1991, two US subsidiary companies transferred their shares in a Swiss company to their US parent company. The Federal Supreme Court held that the share transfer to the US parent company was not tax

52. See Philip Baker, "Editor's note", *International Tax Law Reports* 4 (2002), p. 193.

53. Art. 22(3)(a)(ii) of the Switzerland–US tax treaty and Para. 7 of its complementing Memorandum of Understanding. See Peter Reinarz, "Swiss/US pact sets strict limitation on benefits", *International Tax Report* (1996), pp. 1-6.

54. See Para. 17 of the OECD Commentary on Art. 10(2).

55. Federal Supreme Court, 9 November 1984, BGE 110 IB 287.

56. Federal Supreme Court, 16 August 1996, 66 *Archiv für Schweizerisches Abgaberecht* 6/7 (1997/98), pp. 406-416.

abuse under the long-standing Swiss judicial anti-abuse doctrine, as the transfer was not apparently unusual and inappropriate with regard to the economic facts. It, however, held that the association between the US parent company and the Swiss company was established mainly with the intention of benefiting from the lower treaty rate. As a result, the Federal Supreme Court refused the Federal withholding tax relief due on distributions of "old reserves" by the Swiss company to the US parent company to the extent that the previous US subsidiary companies would not have been entitled to such refunds because of the higher treaty rate. Similarly to its decision of 9 November 1984 on Art. 9(2)(a)(i) of the Netherlands–Switzerland tax treaty, the Federal Supreme Court refused the application of the lower treaty rate based on Art. VI(2) of the old Switzerland–US tax treaty. In other words, the Federal Supreme Court refused the application of the "old reserves" doctrine based on Art. 21(2) of the VStG.

2.2.6. Triangular cases

Triangular cases are dealt with in the OECD Commentary, but are not specifically covered by the OECD Model.[57] Art. 10 of the OECD Model only deals with dividends paid by a company that is a resident of one state to a resident of the other state. Accordingly, it does not cover dividends paid by a company resident in a third state or dividends paid by a company that is a resident of a state, which are attributable to a permanent establishment (PE) that an enterprise of that state has in the other state.[58] Similarly, Art. 11 and Art. 12 of the OECD Model do not cover interest and royalties arising in a third state or interest arising in a state that is attributable to a PE that an enterprise of that state has in the other state.[59] In contrast to Art. 10 to Art. 12 of the OECD Model, as discussed in 3.3.3. and 3.4.3., EC law covers triangular cases.

3. INTERPRETATION AND APPLICATION OF ART. 15 OF THE ZBstA

3.1. Scope

Art. 15 of the ZBstA has considerable importance in the Swiss treaty context, as it occupies the same ground in many respects as Art. 10 to Art. 12 of the OECD Model. The purpose of Art. 15 of the ZBstA is the avoidance of the international juridical double taxation of dividends, interest and royalties paid between affiliated companies in the Switzerland-EC cross-border context.[60] The equivalent measures are set out in Art. 5(1) of the EC Parent-Subsidiary and Art. 1(1) of the Interest and Royalties Directives. Art. 15 of the ZBstA disregards the measures for the avoidance of the international economic multiple taxation of corporate profits in the state of residence of the parent company in Art. 4(1) of the EC Parent-Subsidiary Directive.[61] Accordingly, the scope of Art. 15 of the ZBstA is limited to source taxation in an inbound and outbound context.

3.2. ECJ case law

Similarly to the OECD Commentary, the decisions of foreign courts do not fit easily with Art. 31 to Art. 33 of the Vienna Convention. Should, therefore, ECJ case law be considered regarding the interpretation of Art. 15 of the ZBstA? Art. 16(2) of the Free Movement Agreement provides that, insofar as the application of the Agreement involves concepts and terms of EC law, account is taken of the relevant ECJ case law before the date of its signature.[62] At the request of either state, a Joint Committee determines the implications of this case law to ensure that the Free Movement Agreement works properly. The Federal Supreme Court has stated that ECJ case law after the date of signature is not binding,[63] but that later case law may be taken into account.[64] Cottier and Evtimov take the view that, under Art. 31(1) of the Vienna Convention, the ECJ decisions given after the date of signature should be considered, insofar as these are necessary for interpretation in good faith.[65]

Despite the fact that the ZBstA does not include a reference *expressis verbis* similar to that in Art. 16(2) of the Free Movement Agreement, in the author's view, it must be concluded that, insofar as the application of the ZBstA involves concepts and terms of EC law, account should be taken of the relevant ECJ case law before and after the date of signature of the Agreement. Under Art. 12 of the ZBstA, in any disagreement regarding its interpretation or application, the competent authorities will endeavour to resolve this by mutual agreement. This provision follows Art. 25(3) of the OECD Model, under which the competent authorities can, if a term has been incompletely or ambiguously defined in a tax treaty, complete or clarify its definition to obviate any difficulty by mutual agreement.[66] Under Art. 4, first indent of the MoU, the states have also agreed to implement the agreed measures in good faith and not to act unilaterally to undermine the arrangement without due cause.[67] It should be emphasized that Switzerland did not request the elimination

57. See Marco Lombardi, "Triangular Situations: A Case of Double Source Taxation of Interest and Royalties", 51 *Bulletin for International Fiscal Documentation* 4 (1997), pp. 177-182.
58. Para. 8 of the OECD Commentary on Art. 10(1). See also Paras. 9 and 10 of the OECD Commentary on Art. 23A and B.
59. Para. 6 of the OECD Commentary on Art. 11(1) and Para. 5 of the OECD Commentary on Art. 12(1). See also Paras. 9 and 10 of the OECD Commentary on Art. 23A and B.
60. The territorial scope of the ZBstA is defined in Art. 20. See also FTA Guidelines on Art. 15(1) of the ZBstA of 15 July 2005, Para. 1.
61. Switzerland mitigates or avoids the economic multiple taxation of corporate profits by a participation relief in Art. 69 and Art. 70 of the Federal Income Tax Act of 14 December 1990 (*Bundesgesetz über die direkte Bundessteuer*, DBG) and Art. 28(1) and (1)bis of the Federal Act on the Harmonization of the Cantonal and Communal Income Taxes of 14 December 1990 (*Bundesgesetz über die Harmonisierung der direkten Steuern der Kantone und Gemeinden*, StHG).
62. See also Art. 6 of the EEA Agreement and Art. 3(2) of the Agreement of 2 May 1992 on the establishment of a Surveillance Authority and a Court of Justice.
63. See, for example, Federal Supreme Court, BGE 129 II 215, Para. 4.2, BGE 129 II 249, Para. 5.2, and BGE 130 II 176, Para. 2.1.
64. See, for example, Federal Supreme Court, BGE 130 II 1, Para. 3.6.1.
65. Thomas Cottier and Erik Evtimov, "Die sektoriellen Abkommen der Schweiz mit der EG: Anwendung und Rechtsschutz", 139 *Zeitschrift des Bernischen Juristenvereins* (2003), p. 109 et seq.
66. Para. 34 of the OECD Commentary on Art. 25(3).
67. Art. 4, second indent MoU.

of source taxation on intercompany dividends, interest and royalties by the revision of existing tax treaties with the Member States. Instead, Switzerland requested the inclusion of measures "equivalent" to the regimes provided for in the EC Parent-Subsidiary and the Interest and Royalties Directives in their "original versions".[68] This is to permit Switzerland, in its relations with the Member States, to benefit from the EC Parent-Subsidiary and the Interest and Royalties Directives.[69] In other words, Art. 15 of the ZBstA does not provide for straightforward measures following Art. 10 to Art. 12 of the OECD Model. Instead, under Art. 31 of the Vienna Convention, the interpretation in good faith and the context in which Art. 15 of the ZBstA was adopted require that the relevant ECJ case law before and after the date of signature of the ZBstA must be considered, insofar as its application involves concepts and terms of the EC Parent-Subsidiary and the Interest and Royalties Directives. Accordingly, the legal basis for reference to ECJ case law in Art. 15 of the ZBstA is apparently significantly stronger than the reference to the OECD Commentary. It should be remembered that ECJ case law on direct taxation is generally a success story for taxpayers. Reference to ECJ case law may also be justified by the "concept of common interpretation"[70] and there is a growing number of cases in international tax law in which this concept has been followed.

3.3. Intercompany dividends

3.3.1. Elimination of source taxation

Art. 4(1) and Art. 5 of the EC Parent-Subsidiary Directive address the avoidance of international economic double taxation of "distributed profits" in the state of residence of the parent company and the elimination of source taxation in the state of residence of the subsidiary company. In contrast, Art. 15(1) of the ZBstA, which is limited to source taxation in the state of residence of the subsidiary company, uses the term "dividends paid". It is prima facie unclear whether or not Art. 15(1) of the ZBstA provides for an equivalent term to that set out in Art. 5 of the EC Parent-Subsidiary Directive. On 15 July 2005, the FTA issued Guidelines regarding the elimination of Federal withholding tax on dividend payments between affiliated companies in the Switzerland-EC cross-border context under Art. 15(1) of the ZBstA and Circular No. 10 on the international reporting procedure under Art. 15(1) of the ZBstA (addition to Circular No. 6 of 22 December 2004). The FTA takes the view that the term "dividend" in Art. 15(1) of the ZBstA follows Art. 10 of the OECD Model.[71] As discussed in 3.2., there are, however, apparently strong legal arguments for a uniform interpretation of the term "dividends paid" in Art. 15(1) of the ZBstA and the EC law term "distributed profits". Art. 4(1) of the EC Parent-Subsidiary Directive excludes liquidation distributions only in respect of a parent company.[72] Accordingly, Art. 15(1) of the ZBstA also covers liquidation distributions.[73]

There are a number of requirements that must be complied with to fall within Art. 15(1) of the ZBstA. The parent company must hold directly at least 25% of the capital of the distributing subsidiary company for a minimum of two years.[74] In contrast, under Art. 3(2), first indent of the EC Parent-Subsidiary Directive, Member States may replace the criterion of a holding in the capital with that of a holding of voting rights using a bilateral agreement and, under Art. 3(2), second indent, Member States may unilaterally introduce an uninterrupted two-year holding period requirement. The holding threshold for Art. 3(1) of the EC Parent-Subsidiary Directive has been reduced to 20% and will be further reduced to 10%.

Art. 15(1) of the ZBstA requires that one company is resident in a Member State and the other is resident in Switzerland, that both companies are subject to corporation tax without being exempted (subject-to-tax clause) and that both have the form of a limited company.[75] The subject-to-tax clause raises the question of whether or not a company enjoying holding status for Cantonal/Communal tax purposes has access to the benefits of Art. 15 of the ZBstA.[76] The FTA treats Swiss holding companies as subject to corporation tax under Art. 15 of the ZBstA.[77] Swiss holding companies are exempted from corporation tax, but only if they meet all of the requirements specified in Cantonal tax laws. Accordingly, they are subject to the tax laws of Switzerland and are generally treated as resident persons under tax treaties.[78] Art. 15(1) of the ZBstA also requires that, under any tax treaty with a third state, neither company is resident in that third state (dual residence companies).

68. Council Decision 2004/911/EC of 2 June 2004 on the signing and conclusion of the Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments and the accompanying Memorandum of Understanding, Official Journal (EC), L 385, 29 December 2004, p. 28.

69. See also the decision of the Federal Commission, note 18 regarding Art. 10(2)(a)(i) of the Luxembourg–Switzerland tax treaty, as discussed in 2.2.4. with regard to the context in which the provision was adopted.

70. See Baker, note 28, Introductory Topics, Para. E.26 et seq. See also Para. 5 of the Introduction of the OECD Commentary.

71. FTA Guidelines on Art. 15(1) of the ZBstA of 15 July 2005, Para. 3.

72. See Sec.122(5)(b) of the Taxation of Capital Gains Act 1992, under which UK tax law treats a capital distribution in the dissolution or winding up of a company as a capital gain for capital gains tax purposes, rather than income for income tax purposes.

73. FTA Guidelines on Art. 15(1) of the ZBstA of 15 July 2005, Para. 3. Howard Hull takes the contrasting view that total liquidation payments are not covered by Art. 15(1) of the ZBstA. See Howard Hull, "The EC Parent Subsidiary Directive in Switzerland – Swiss Outbound Dividends", 59 *Bulletin for International Fiscal Documentation* 2 (2005), p. 70.

74. The FTA takes the view that the interposition of a fiscally transparent partnership does not conflict with Art. 15(1) of the ZBstA. See FTA Guidelines on Art. 15(1) of the ZBstA of 15 July 2005, Para. 3. See also Art. VI of the Protocol of 12 March 2002 to the Germany–Switzerland tax treaty.

75. Under note 6 of the ZBstA, with regard to Switzerland, the term "limited company" covers corporations, corporations with unlimited partners and limited liability companies. Accordingly, cooperatives cannot access the benefits of Art. 15(1) of the ZBstA. See FTA Guidelines on Art. 15(1) of the ZBstA of 15 July 2005, Para. 9(a). See also the subject-to-tax clauses and the other clauses in Para. 13 et seq. of the OECD Commentary on Art. 1, addressing harmful preferential tax regimes added by the 2003 Revision.

76. Art. 28(2) StHG.

77. Swiss resident companies that are subject to Art. 28(2) and (3) of the StHG also fulfil the subject-to-tax clause (FTA Guidelines on Art. 15(1) of the ZBstA of 15 July 2005, Paras. 8(iv) and (v)). Swiss resident companies that are tax exempt under Art. 56 of the DBG and Art. 23 of the StHG or Swiss resident companies that are fully or almost fully tax exempt under Art. 6 of the Federal Decree of 6 October 1995 on measures in favour of the economic development of areas and Art. 23(3) of the StHG have, however, no access to the benefits of Art. 15 of the ZBstA (FTA Guidelines on Art. 15(1) of the ZBstA of 15 July 2005, Paras. 8(ii) and (vi)).

78. See also Para. 8.2 of the OECD Commentary on Art. 4(1).

3.3.2. PEs

As Switzerland requested the inclusion of equivalent measures to the regimes provided for in the EC Parent-Subsidiary Directive in its original version in the ZBstA, the amendments introduced by Directive 2003/123/EC, in particular, the extension of the scope to PEs, are disregarded in respect of Art. 15(1).[79]

3.3.3. Triangular cases

In contrast to Art. 10 of the OECD Model, as discussed in 2.2.6., under Art. 1(a) of the EC Parent-Subsidiary Directive, a triangular case, in which the parent company and its subsidiary reside in the same Member State and the PE of the parent company is located in another Member State, is covered. It is unclear why Switzerland has not requested the extension of Art. 15(1) of the ZBstA to PEs as in Art. 15(2). The asymmetries between Art. 15(1) of the ZBstA and Art. 1(a) of the EC Parent-Subsidiary Directive and between Art. 15(1) and (2) of the ZBstA should, therefore, be eliminated by the review process in Art. 13 of the ZBstA.

In the light of the *Saint-Gobain*[80] case, should, therefore, a PE located in a Member State of a company residing in another Member State have access to Art. 15(1) of the ZBstA? In this case, the ECJ stated that, in respect of a tax treaty between a Member State and a non-Member State, freedom of establishment in the EC Treaty requires the Member State to grant to the PEs of non-resident companies the advantages provided for by the EC Treaty under the same conditions as those applying to resident companies.[81] The ECJ pointed out that the balance and the reciprocity of the tax treaties concluded with third states would not be questioned by a unilateral extension, as the extension would not affect the rights of the non-Member States that are parties to the tax treaties and would not impose any new obligation on them.[82] The Commission has noted that this case implies that a PE must be granted benefits under tax treaties, including those with third states, concluded by the Member State in which the PE is located.[83] Accordingly, apparently a PE located in a Member State of a company residing in another Member State has access to Art. 15(1), regardless of the multilateral nature of the ZBstA. A unilateral extension of Art. 15(1) of the ZBstA by the Member States has, however, no direct effect on Federal withholding tax on Swiss-source dividends.

3.3.4. Indirect domestic tax credit

The *Océ van der Grinten*[84] case considered the interpretation of Art. 10(3)(a)(ii) of the Netherlands–UK tax treaty, the wording of which is similar to Art. 10(3)(a)(iii) of the Switzerland–UK tax treaty discussed in 2.2.2. In this case, a Netherlands parent company argued against the imposition of the UK 5% charge on the repayment of the tax credit plus dividends under Art. 10(3)(a)(ii) of the Netherlands–UK tax treaty. The ECJ stated that, insofar as the 5% charge in the tax treaty is imposed on the dividends distributed by the resident subsidiary to its non-resident parent company, it must be regarded as a withholding tax on distributed profits, in principle, prohibited by Art. 5(1) of the EC Parent-Subsidiary Directive. In contrast, the part of the 5% charge applying to the tax credit, to which the distribution of the dividends confers entitlement, does not posses the characteristics of a withholding tax on distributed profits, as it is not imposed on the profits distributed by the subsidiary. The ECJ referred to Art. 7(2) of the EC Parent-Subsidiary Directive. It maintained that the withholding tax, insofar as it is imposed on the dividends, may be regarded as falling within agreement-based provisions relating to the payment of tax credits to the recipient of dividends and as designed to mitigate economic multiple taxation of corporate profits. Under Art. 7(2) of the EC Parent-Subsidiary Directive, the application of domestic or agreement-based provisions designed to eliminate or reduce economic multiple taxation of dividends is unaffected by provisions relating to the payment of tax credits to the recipients of the dividends. The ECJ concluded that Art. 7(2) of the EC Parent-Subsidiary Directive allows taxation, such as the 5% charge in Art. 10(3)(a)(ii) of the Netherlands–UK tax treaty, even though this charge, insofar as it applies to dividends paid by the subsidiary to its parent company, is a withholding tax within Art. 5(1) of the Directive.

Does, therefore, the 5% charge specified in Art. 10(3)(a)(iii) of the Switzerland–UK tax treaty comply with Art. 15(1) of the ZBstA, insofar as it is imposed on the dividends?[85] Art. 15 of the ZBstA prevails over a less favourable provision in the Switzerland–UK tax treaty (*lex posterior derogat legi priori*).[86] In contrast to the EC Parent-Subsidiary Directive, Art. 15 of the ZBstA does not provide for a reservation equivalent to Art. 7(2) of the Directive. Accordingly, apparently the 5% UK charge, insofar as it is imposed on the UK dividends, conflicts with Art. 15 of the ZBstA. Art. 15(1) of the ZBstA does not, however, preclude the 5% charge, insofar as it is imposed on the UK tax credit.

79. Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, Official Journal (EC), L 7, 13 January 2004, p. 41.

80. ECJ, 21 September 1999, Case C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v. Finanzamt Aachen-Innenstadt* [1999] ECR I-6161.

81. Id., Para. 58.

82. See also ECJ, 5 July 2005, Case C-376/03, *D. v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen*, Para. 61 regarding the compatibility of a provision in a tax treaty that is not extended to nationals of a Member State, which is not party to that tax treaty, with Art. 56 and Art. 58 of the EC Treaty. The ECJ held that the fact that the reciprocal rights and obligations apply only to persons resident in one of the two Member States is an inherent consequence of tax treaties.

83. Commission of the European Communities, Commission Staff Working Paper, "Company Taxation in the Internal Market", SEC(2001) 1681, p. 288.

84. ECJ, 25 September 2003, Case C-58/01, *Océ van der Grinten NV v. Commissioners of Inland Revenue* [2003] ECR I-9809. See Schwarz, note 25, p. 158 et seq. and Jonathan Schwarz, "European Corporate Group Structures and Financing: The Impact of European Court Decisions and European Legislative Developments", 57 *Bulletin for International Fiscal Documentation* 11 (2003), p. 517 et seq. See also EFTA Court, 23 November 2004, Case E-1/04, *Fokus Bank ASA v. The Norwegian State* EFTA Ct. Rep. (2004), p. 15; *International Tax Law Reports* 7 (2005), pp. 367-382, regarding the incompatibility of the Norwegian legislation, under which the grant of a tax credit is excluded if the recipient shareholder is not resident in that state (outbound dividends). See again ECJ, 7 September 2004, Case C-319/02, *Petri Manninen* [2004] ECR I-7477, Para. 51, regarding the incompatibility of the Finnish legislation, under which the grant of a tax credit is excluded if the distributing company is not established in that state (inbound dividends).

85. See FTA Notice R-GB-M on tax relief for UK-source income of 2003.

86. Art. 30(2) of the Vienna Convention. See also Art. 15(3) of the ZBstA.

3.3.5. CFC legislation

Should the Member States' CFC legislation comply with Art. 15(1) of the ZBstA? As noted in 2.2.3.1., under Para. 23 of the OECD Commentary on Art. 1 as revised in 2003, CFC legislation is generally not contrary to the provisions of the OECD Model.[87] The Member States' CFC legislation is also apparently in line with the EC Parent-Subsidiary Directive. Member States that tax CFC profits as deemed dividends before the profit is actually distributed must, however, exempt these dividends or credit the underlying taxes paid by the CFC under Art. 4(1) of the EC Parent-Subsidiary Directive.[88] As Art. 15(1) of the ZBstA disregards Art. 4(1) of the EC Parent-Subsidiary Directive, Art. 15(1) apparently does not restrict the application of CFC legislation in relation to Switzerland.

In the *Bosal Holding*[89] case, the ECJ held that the option in Art. 4(2) of the EC Parent-Subsidiary Directive may be exercised only in compliance with the fundamental provisions of the EC Treaty. Accordingly, the Member States' CFC legislation must comply not only with the EC Parent-Subsidiary Directive, but also with Art. 56(1) and (2) of the EC Treaty, under which restrictions on the free movement of capital and payments between the Member States and between Member States and "third countries" are prohibited.[90] As a result, the EC Treaty may also preclude the Member States' CFC legislation in relation to third countries. According to scholarly writing, it is unlikely that the UK CFC regime will survive its forthcoming consideration by the ECJ in the *Cadbury Schweppes*[91] case. In the light of the EC principle of proportionality discussed in 3.6.2.2., apparently only CFC legislation that counteracts "wholly artificial arrangements" complies with the EC Treaty.[92] Regarding the UK CFC regime, Cadbury Schweppes plc is the UK resident parent company of two indirect 100% subsidiaries residing in Ireland. Accordingly, even after the decision, the compatibility of CFC legislation in relation to third countries may remain unresolved.

3.3.6. Transitional provisions

These relate to Estonia, which may, as long as it charges income tax on distributed profits without taxing undistributed profits and, at the latest, until 31 December 2008, tax profits distributed by Estonian subsidiary companies to their Swiss parent companies.[93]

3.4. Intercompany interest and royalties

3.4.1. Elimination of source taxation

Under Art. 15(2) of the ZBstA, interest and royalty payments between associated companies or their PEs are not subject to source taxation. The term "interest and royalties payments" is equivalent to that in Art. 1(1) of the Interest Royalties Directive. Presumably, the FTA applies the Guidelines on Art. 15(1) of the ZBstA of 15 July 2005 mutatis mutandis to interest and royalties under Art. 15(2) of the ZBstA.

Art. 15(2) of the ZBstA requires that the companies are affiliated by a direct holding of at least 25% for a minimum of two years (vertical affiliation) or both are held by a third company that has a direct holding of at least 25% in the capital of both companies for a minimum of two years (horizontal affiliation). Under Art. 3(b)(iii) of the Interest and Royalties Directive, Member States may replace the criterion of a holding in the capital with that of a holding of voting rights and, under Art. 1(10), Member States may unilaterally introduce an uninterrupted two-year holding period requirement. Art. 15(2) of the ZBstA also requires that a company is resident or that the PE is located in a Member State, and the other company is resident or the PE is located in Switzerland. In addition, Art. 15(2) of the ZBstA requires that, under any tax treaty with a third state, none of the companies is a resident in that third state (dual resident companies) and none of the PEs is located in that third state. It is further required that all companies are subject to corporation tax without being exempt, in particular, in respect of interest and royalties (subject-to-tax clause) and are limited companies.[94] Accordingly, in contrast to Art. 15(1) of the ZBstA, Art. 15(2) provides for a specific subject-to-tax clause with regard to the payments received.

3.4.2. PEs

Unlike the EC Parent-Subsidiary Directive, the Interest and Royalties Directive, in its original version, takes into account the *Avoir fiscal*[95] and *Saint-Gobain* cases.

87. With regard to Para. 23, Switzerland has entered an observation, under which Switzerland considers that such legislation may, depending on the relevant concept, be contrary to the spirit of Art. 7 of the OECD Model. See Para. 27.9 of the OECD Commentary on Art. 1.

88. Hans-Jörgen Aigner, Ulrich Scheuerle and Markus Stefaner, "General Report", in: Michael Lang, Hans-Jörgen Aigner, Ulrich Scheuerle and Markus Stefaner (eds.), *CFC Legislation – Domestic Provisions, Tax Treaties and EC Law* (The Hague: Kluwer, 2004), p. 50. See also Marjaana Helminen, "Is there a Future for CFC-regimes in the EU?", 33 *Intertax* 3 (2005), p. 118 et seq.

89. ECJ, 18 September 2003, Case C-168/01, *Bosal Holding BV v. Staatssecretaris van Financiën* [2003] ECR I-9409, Para. 26. Under Art. 4(2) of the EC Parent-Subsidiary Directive, Member States retain the option to provide that any charges relating to the holding and any losses resulting from the distribution of the profits of a subsidiary may not be deducted from the taxable profits of the parent company.

90. See the transitional measure in Art. 57 of the EC Treaty. See also *X BV*, Appeal Court of Amsterdam (Third Plural Tax Chamber), 2 March 2005, unofficial translation in *International Tax Law Reports* 7 (2005), pp. 689-717 regarding the refusal of a deduction of the expenditure relating to the taxpayer's participations in third countries. See again ECJ, Advocate General Léger's Opinion, 30 June 2005, Case C-513/03, *Erven van M. E. A. van Hilten-van der Heijden v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen* regarding the question of whether or not Art. 73b (now Art. 56) of the EC Treaty precludes Netherlands legislation imposing inheritance taxes following the transfer of residence from the Netherlands to Switzerland.

91. ECJ, Pending Case C-196/04, *Cadbury Schweppes and Cadbury Schweppes Overseas*. See, for example, Helminen, note 88, pp. 117-123 and Derek Hill, "The CFC regime: Restricting EU fundamental freedoms?", *Financial Instruments Tax and Accounting Review* (2005), pp. 1-5.

92. In respect of abusive arrangements, CFC profits may be also taxed under CFC legislation that is based on the anti-abuse provisions in Art. 1(2) of the EC Parent-Subsidiary Directive.

93. Art. 15(1) ZBstA.

94. Under note 7 of the ZBstA, with regard to Switzerland, the term "limited company" covers corporations, corporations with unlimited partners and limited liability companies. Accordingly, cooperatives cannot access the benefits of Art. 15(2) of the ZBstA. See also the subject-to-tax clauses and the other clauses in Para. 13 et seq. of the OECD Commentary on Art. 1 that address harmful preferential tax regimes, which were added by the 2003 Revision.

95. ECJ, 28 January 1986, Case 270/83, *Commission of the European Communities v. French Republic (Avoir fiscal)* [1986] ECR 273.

Accordingly, Art. 15(2) of the ZBstA covers payments by or to PEs.

3.4.3. Triangular cases

As discussed in 3.2., there are apparently strong legal arguments for a uniform interpretation of triangular cases under Art. 15(2) of the ZBstA and the EC law.[96] Accordingly, in contrast to Art. 11 and Art. 12 of the OECD Model, as discussed in 2.2.6., Art. 15(2) of the ZBstA also covers a triangular case in which the associated companies are resident in the same state and the PE of one of the associated companies is located in the other state. Similarly to Art. 15(1) of the ZBstA, in the author's view, the spirit of Art. 15(2) implies a requirement for cross-border interest or royalties.

3.4.4. Standard tax relief procedure

As discussed in 2.1.2., from 1 January 2005, Switzerland has introduced a new relief-at-source procedure for cross-border intercompany dividends under a tax treaty or other agreement (for example, the ZBstA). The new relief-at-source procedure was apparently enacted in anticipation of Art. 15 of the ZBstA, under which intercompany dividends, interest and royalties "shall not be subject to taxation in the source State". The new Swiss relief-at-source procedure, however, only applies to cross-border intercompany dividends. Does, therefore, Art. 15(2) of the ZBstA preclude the application of the standard tax relief procedure for cross-border intercompany interest payments? Art. 5 of the EC Parent-Subsidiary Directive states that intercompany profit distributions "shall be exempt from withholding tax" and Art. 1(1) of the Interest and Royalties Directive states that intercompany interest and royalties arising in a Member State "shall be exempt from any taxes imposed on those payments in that State". The term "exempt" indicates that exemption at source is mandatory.[97] The unequal treatment of intercompany dividends and interest is contrary to the spirit of Art. 15 of the ZBstA and, therefore, particularly in the light of a uniform interpretation, should be eliminated by the extension of the new relief-at-source procedure to payments under Art. 15(2).

3.4.5. Transitional provisions

As the Interest and Royalties Directive provides for a transitional period with regard to certain Member States, these Member States will only ensure the provision of the arrangements on interest and royalties after the end of this period.[98] Specifically, Art. 6 of the Interest and Royalties Directive, as amended by Directive 2004/76/EC, provides for transitional rules in respect of the Czech Republic, Greece, Latvia, Lithuania, Portugal, the Slovak Republic and Spain.[99]

3.5. More favourable tax treaties with Member States

Art. 15(3) of the ZBstA states that the existing tax treaties between Switzerland and Member States that provide for a more favourable taxation treatment in respect of dividends, interest and royalties at the time of adoption of the ZBstA are unaffected.[100] Accordingly, taxpayers can choose between the application of a tax treaty and Art. 15 of the ZBstA.[101] For example, the Swiss tax treaties with Austria (a direct holding of at least 20% of the capital), France (a direct or indirect holding of at least 10% of the capital) and Germany (a direct holding of at least 20% of the capital) provide for a lower holding threshold for intercompany dividends than Art. 15(1) of the ZBstA and, therefore, may be more favourable.[102] With regard to the minimum holding period, the Swiss tax treaties with Austria, Denmark, Germany, the Netherlands and Sweden may be more favourable.

Art. 15(3) of the ZBstA includes the principle of *lex posterior non derogat legi priori*, insofar as an existing tax treaty is more favourable than Art. 15. The FTA takes the view that the taxpayer can choose either the application of a tax treaty or Art. 15 of the ZBstA.[103] In the author's view, however, it is unclear as to whether or not a particular more favourable tax treaty requirement prevails over a particular requirement of Art. 15 of the ZBstA, for example a lower minimum holding threshold or no minimum holding period. It should be also noted that it is the *ratio legis* of Art. 15 of the ZBstA that amendments to tax treaties that provide for a more favourable tax treatment, which come into force after the adoption of the ZBstA, prevail over Art. 15 (*lex posterior derogat legi priori*).[104]

3.6. Bilateral and unilateral anti-abuse provisions

3.6.1. Discretion regarding anti-abuse measures

Art. 1(2) of the EC Parent-Subsidiary and Art. 5(1) of the Interest and Royalties Directives preserve the application of domestic or agreement-based provisions for the prevention of fraud or abuse.[105] The Member States must, however, draft their anti-abuse measures consistently with EC law. As Switzerland requested the inclusion of equivalent measures in the ZBstA, in the author's view, anti-abuse measures within the context of Art. 15(1) and (2) must also comply with EC law.

3.6.2. EC anti-abuse measures

3.6.2.1. *Two-year holding period*

Art. 3(2), second indent of the EC Parent-Subsidiary Directive provides for a specific anti-abuse measure

96. See Michele Gusmeroli, "Triangular Cases and the Interest and Royalties Directive: Untying the Gordian Knot? Parts 1 to 3", 45 *European Taxation* 1, 2 and 3 (2005), pp. 2-13, pp. 39-51 and pp. 86-96.
97. Ben Terra and Peter Wattel, *European Tax Law*, fourth edition (The Hague: Kluwer, 2005), pp. 517 and 628.
98. Art. 15(2) ZBstA.
99. Council Directive 2004/76/EC of 29 April 2004 amending Directive 2003/49/EC as regards the possibility for certain Member States to apply transitional periods for the application of a common system of taxation applicable to interest and royalty payments between associated companies of different Member States, Official Journal (EC), L 157, 30 April 2004, p. 106.
100. Art. 14 ZBstA.
101. FTA Guidelines on Art. 15(1) of the ZBstA of 15 July 2005, Para. 13.
102. Art. 10(2) of the Austria–Switzerland, Art. 11(2)(b)(i) of the France–Switzerland and Art. 10(3) of the Germany–Switzerland tax treaties.
103. FTA Guidelines on Art. 15(1) of the ZBstA of 15 July 2005, Para. 13.
104. Id., Para. 13.
105. Dennis Weber, "A closer look at the general anti-abuse clause in the Parent-Subsidiary Directive and the Merger Directive", *EC Tax Review* 2 (1996), pp. 63-69.

under which the Member States may unilaterally introduce a two-year holding period requirement. In the *Denkavit*[106] case, the ECJ stated that Art. 1(2) of the EC Parent-Subsidiary Directive is a provision of principle and Art. 3(2) is intended to counteract abuse, whereby holdings are taken in the capital of companies for the sole purpose of benefiting from the tax advantages available and which are not intended to be lasting. The ECJ also held that a parent company is not required to fulfil the minimum holding period on the profit distribution and that it is for the Member States to draw up rules to ensure compliance with the minimum holding period.[107]

3.6.2.2. *Principle of proportionality*

Unilateral anti-abuse provisions based on Art. 1(2) of the EC Parent-Subsidiary and Art. 5(1) of the Interest and Royalties Directives must be applied under the EC principle of proportionality. In the *Leur-Bloem*[108] case, the ECJ stated that a general rule automatically excluding certain categories of operations from the tax advantage, whether or not there is actually tax evasion or tax avoidance, goes further than that necessary to prevent such tax evasion or tax avoidance. The ECJ concluded that tax administrations must subject each particular case to a general examination (the per concrete case test).[109] In other words, unilateral anti-abuse provisions must be appropriate and the taxpayers must at least have the opportunity to show that there were bona fide commercial reasons involved.[110] According to the *Eurowings*[111] case, to find abuse, minimally, artifice must be present. From the *ICI* and *Lankhorst-Hohorst*[112] cases, it may also be inferred that the ECJ only considers abuse to be present if the corporate structures at issue are "wholly artificial arrangements". The ECJ has recently confirmed its case law by way of an obiter dictum in the *Marks & Spencer*[113] decision, i.e.:

> It is also important ... to make clear that Member States are free to adopt or to maintain in force rules having the specific purpose of precluding from a tax benefit wholly artificial arrangements whose purpose is to circumvent or escape national tax law ...

The CFA tends towards a similar concept of tax abuse (see 2.2.3.1.). In addition, the ECJ stated that the mere use of the right to free movement in the EC Treaty does not necessarily entail tax abuse, as taxpayers are subject to the tax legislation of the Member State of establishment.[114] National courts must stay within these boundaries of the EC principle of proportionality that outline the margin of discretion for the Member States.[115]

3.6.2.3. *Abuse-of-rights doctrine*

Advocate General Poiares Maduro has given his Opinion in the *Halifax*[116] case. In this case, the ECJ has been asked to consider the possible application of the abuse-of-rights doctrine with regard to VAT, as a result of which claims for the recovery of, or relief for, input VAT could be disallowed.[117] In the light of ECJ case law, the Advocate General took the view that the term "abuse" is a principle governing the interpretation of EC law. The Advocate General noted that, in the *Emsland-Stärke*[118] case, the ECJ linked the subjective element of abuse to the finding that the situation giving rise to the application of a certain Community rule was purely artificial. He also pointed out that the reference to a subjective element is understandable in the light of the circumstances of the *Emsland-Stärke* case.[119] In that case, the parties to the transaction intended, from the outset, to have the merchandise re-enter the territory of the EC and had no intention of exporting the merchandise to Switzerland. The Advocate General took the view that the "artificial nature" of certain events or transactions must be determined on the basis of objective elements verified "in each individual case". He also emphasized that it is not the intention that is decisive in the assessment of abuse. It is the activity. Further, the Advocate General argued that the definition of the prohibition of abuse must consider the principles of legal certainty and the protection of taxpayers' legitimate expectations.[120]

In addition, the Advocate General took the view that Art. 27(1) of the Sixth VAT Directive,[121] under which the Member States may be authorized to introduce special measures derogating from the Directive to prevent

106. ECJ, 17 October 1996, Joined Cases C-283/94, C-291/94, C-292/94, *Denkavit International BV, VITIC Amsterdam BV and Voormeer BV v. Bundesamt für Finanzen* [1996] ECR I-5063, Para. 31.
107. Id., Para. 32. See also Jonathan Schwarz, "Current Issues under European Community Law on Cross-Border Dividends", 55 *Bulletin for International Fiscal Documentation* 2 (2001), p. 46 et seq.
108. ECJ, 17 July 1997, Case C-28/95, *A. Leur-Bloem v. Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2* [1997] ECR I-4161, Para. 44. Art. 11(a) of the EC Merger Directive states that Member States may refuse to apply or withdraw the benefit of the Directive if, apparently, the operation has as "its principal objective or as one of its principal objectives tax evasion or tax avoidance". This may be presumed if the operation "is not carried out for valid commercial reasons …". Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, Official Journal (EC), L 225, 20 August 1990, p. 1.
109. Id., Para. 41.
110. Terra and Wattel, note 97, p. 564.
111. ECJ, 26 October 1999, Case C-294/97, *Eurowings Luftverkehrs AG v. Finanzamt Dortmund-Unna* [1999] ECR I-7447.
112. ECJ, 16 July 1998, Case C-264/96, *Imperial Chemical Industries plc (ICI) v. Kenneth Hall Colmer (Her Majesty's Inspector of Taxes)* [1998] ECR I-4659, Para. 26 and ECJ, 12 December 2002, Case C-324/00, *Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt* [2002] ECR I-11779, Para. 37. In UK tax legislation, Sec. 44(3) of the Finance (No. 2) Act 1915 provided for an anti-abuse measure regarding "fictitious or artificial operation". See *The Scottish Adhesives Company v. Commissioners of Inland Revenue*, The Accountant Tax Cases [1922], p. 42.
113. ECJ, 13 December 2005, Case C-446/03, *Marks & Spencer plc. v. David Halsey (Her Majesty's Inspector of Taxes)*, Para. 57. See also Violeta Ruiz, "Tax Avoidance and the European Court of Justice: What is at Stake for European General Anti-Avoidance Rules?", *Intertax* (2005), pp. 562-583.
114. *ICI*, note 112, Para. 26 and *Lankhorst-Hohorst*, note 112, Para. 37.
115. Weber, note 105 p. 64.
116. ECJ, Advocate General Poiares Maduro's Opinion, 7 April 2005, Joined Cases C-255/02, C-419/02, C-223/03, *Halifax and others* regarding the question of whether or not the doctrine of abuse of rights applies to disallow a claim for recovery of, or relief for, input VAT.
117. See Roderick Cordara, "*Halifax*: a conservative opinion", *British Tax Review* 3 (2005), pp. 267-270; Peter Harris, "*Abus de droit* in the Field of Value Added Taxation", *British Tax Review* 2 (2003), pp. 131-152; and Michael Ridsdale, "Abuse of rights, fiscal neutrality and VAT", *EC Tax Review* 2 (2005), pp. 82-94.
118. ECJ, 14 December 2000, Case C-110/99, *Emsland-Stärke GmbH v. Hauptzollamt Hamburg-Jonas* [2000] ECR I-11569, Para. 53.
119. *Halifax*, note 116, Para. 69, note 64.
120. Id., Para. 83.
121. Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, Official Journal (EC), L 145, 13 June 1977, p. 1.

certain types of tax evasion or tax avoidance, does not preclude the adoption of a doctrine of abuse for the interpretation of the common VAT rules.[122] Finally, he concluded that there is a Community law principle of interpretation prohibiting the abuse of Community provisions that also applies to the Sixth VAT Directive.[123] According to the Advocate General's abuse-of-rights test, the provisions of the Sixth VAT Directive should be interpreted as not conferring on a taxable person the right to deduct or recover input VAT if two objective elements are present in terms to be assessed by the national courts, i.e.:[124]

(1) the objectives and results of the legal provisions formally giving rise to the right would be frustrated if the right claimed were actually conferred; and
(2) the right invoked derives from activities for which there is no other explanation other than the creation of the right claimed.

3.6.3. Swiss anti-abuse measures

3.6.3.1. *Two-year holding period*

With regard to the interpretation of the two-year holding period requirement in Art. 15 of the ZBstA, the FTA requested that the Member States take the *Denkavit* case into account.[125] Except for Portugal, all the Member States agreed with the Swiss request.[126] In the author's view, it is doubtful as to whether or not the Portuguese refusal is in line with the interpretation in good faith and the context in which Art. 15 of the ZBstA was adopted under Art. 31 of the Vienna Convention (see 3.2.). This also apparently conflicts with Art. 10 of the EC Treaty (Community loyalty).

As noted in 2.1.2., the new Swiss relief-at-source procedure only applies to cross-border intercompany dividends. If the two-year holding period is not met when the dividends are paid, the FTA either limits the new relief-at-source procedure to the extent of the reduced treaty rate for intercompany dividends (as noted in 2.2.1., some tax treaties with Member States provide for a zero rate) and, therefore, levies the treaty rate or, in the absence of a tax treaty (regarding Malta and Cyprus), levies the ordinary Federal withholding tax at 35%.[127] A Federal withholding tax relief is granted on request once the two-year holding period is met.

3.6.3.2. *Bilateral beneficial ownership*

In its Guidelines on Art. 15(1) of the ZBstA of 15 July 2005, the FTA refers to the principles of international tax law and considers that the beneficial ownership requirement is implicitly included in Art. 15(1) of the ZBstA.[128] This interpretation complies with the Commentary on Art. 10 to Art. 12 of the OECD Model as revised in 2003 (see 2.2.4.).[129] As noted in 3.4.1., presumably the FTA applies the Guidelines mutatis mutandis to interest and royalties under Art. 15(2) of the ZBstA. The interpretation of the FTA may be based on Art. 15(1) and (2) of the ZBstA, under which the application of agreement-based anti-abuse provisions is preserved. In addition, in the light of a uniform interpretation, as Art. 1(1) of the Interest and Royalties Directive refers to the beneficial ownership requirement, beneficial ownership is implicitly included in Art. 15(2) of the ZBstA.

3.6.3.3. *Unilateral and bilateral anti-abuse measures*

In its Guidelines on Art. 15(1) of the ZBstA of 15 July 2005, the FTA does not refer to the application of the Federal Decree of 14 December 1962 or the specific measures against the improper use of tax treaties noted in 2.2.3.3. and 2.2.5., for example in Art. 22 of the Belgium–Switzerland, Art. 11(2)(b)(ii) and Art. 14 of the France–Switzerland, Art. 23 of the Italy–Switzerland, Art. 9(2)(a)(i) of the Netherlands–Switzerland, and Art. 10(3)(d)(i) of the Switzerland–UK tax treaties. The FTA, however, argues that Art. 15 of the ZBstA is a tax treaty of a multilateral nature and, therefore, applies the Federal Decree of 14 December 1962.[130] The FTA has also announced that it applies in relation to the Netherlands bilateral anti-abuse measures in Art. 9(2)(a)(i) of the Netherlands–Switzerland tax treaty.[131] As discussed in 3.6.1., Art. 15 of the ZBstA preserves the application of such agreement-based provisions. In addition, the FTA applies Art. 14(2) of the Federal Act on Administrative Criminal Law of 22 March 1974 (*Bundesgesetz über das Verwaltungsstrafrecht*) to cases of fiscal fraud (*Abgabebetrug*) and Art. 61 of the VStG to cases of tax evasion (*Steuerhinterziehung*).[132]

3.6.3.4. *"Old reserves" doctrine*

In the light of EC law, as discussed in 3.6.2.2 and 3.6.2.3., does Art. 15(1) and (2) of the ZBstA invalidate Swiss anti-abuse measures in tax treaties and domestic tax law? The Member States' anti-abuse measures must comply, in particular, with the EC principle of proportionality. Switzerland requested the inclusion of a reservation in respect of anti-abuse measures "equivalent" to those in the EC Parent-Subsidiary and the Interest and Royalties Directives. Accordingly, as discussed in 3.2., under Art. 31 of the Vienna Convention and Art. 4, first indent of the MoU, the interpretation in good faith and the context in which Art. 15 of the ZBstA was adopted require that Swiss unilateral anti-abuse measures comply, inter alia, with the EC principle of proportionality.

In its Guidelines on Art. 15(1) of the ZBstA of 15 July 2005, the FTA notes that the mere reduction of the

122. *Halifax*, note 116, Para. 77.
123. Id., Para. 90.
124. Id. See also ECJ, Advocate General Poiares Maduro's Opinion, 7 April 2005, Case C-446/03, *Marks & Spencer plc v. David Halsey (HM Inspector of Taxes)* regarding the question of the prohibition on using losses twice.
125. FTA Guidelines on Art. 15(1) of the ZBstA of 15 July 2005, Para. 5(b).
126. Id., Para. 5(b).
127. See FTA Circular No. 10 on international reporting procedure under Art. 15(1) of the ZBstA of 15 July 2005 (addition to Circular No. 6 of 22 December 2004).
128. FTA Guidelines on Art. 15(1) of the ZBstA of 15 July 2005, Para. 10(a). The author is grateful to Véronique Humbert of the FTA for drawing his attention to this point.
129. The beneficial ownership requirement was introduced by the 2003 Revision to Art. 10 to Art. 12 of the OECD Model to clarify how the articles apply. See Para. 12 of the OECD Commentary on Art. 10(2), Para. 8 of the OECD Commentary on Art. 11(2) and Para. 4 of the OECD Commentary on Art. 12(1).
130. Oliver Gehriger and Robert Waldburger, University of St. Gallen, 21 and 22 September 2005, Seminar No. 3 on Business Taxation: Implementation of Art. 15 of the ZBstA, Handout, p. 12.
131. Id., p. 20.
132. FTA Guidelines on Art. 15(1) of the ZBstA of 15 July 2005, Para. 10. As stated in note 12, fiscal fraud and tax evasion differ from tax abuse.

source tax rates by the ZBstA is not a case of the "old reserves" doctrine.[133] The FTA points out that, in an existing "old reserves" case, in which the shares in a Swiss company were transferred by an EC resident company to another EC resident company before the entry into force of Art. 15 of the ZBstA, the distribution of the "old reserves" may also benefit from the zero rate in Art. 15. Under Art. 15(3) of the ZBstA, the distributing Swiss company can choose between the application of the relevant treaty rate before the transfer (under the "old reserves" doctrine) and the zero rate in Art. 15 of the ZBstA that came into force thereafter.[134] In other words, with the entry into force of Art. 15 of the ZBstA, the presumption of tax abuse ceases to exist. There is no further information regarding the application of the "old reserves" doctrine. The FTA has, however, announced that this may be applied both under a tax treaty with the relevant Member State or under Art. 15 of the ZBstA if shares in a Swiss company are transferred by a non-EC resident company to an EC resident company.[135] Accordingly, if the acquiring EC resident company requests full relief under Art. 15 of the ZBstA, the FTA also applies the "old reserves" doctrine under Art. 15.

In its decision of the Federal Commission of 28 February 2001 on the interpretation of the term "*bénéficiaire*" (beneficial owner) in Art. 10(2)(a)(i) of the Luxembourg–Switzerland tax treaty, the Federal Commission referred to Art. 1(2) of the EC Parent-Subsidiary Directive and argued that Switzerland may apply domestic anti-abuse measures under Art. 10(2)(b) of the tax treaty. It held that the relief for Federal withholding tax is apparently abusive under Art. 21(2) of the VStG (see 2.2.4.). Under Art. 15 of the ZBstA, however, the EC principle of proportionality sets out Switzerland's margin of discretion. The ECJ interprets the principle of proportionality strictly. In the author's view, under the *Leur-Bloem* ("general anti-abuse rules") and the *Eurowings* and *ICI* cases ("wholly artificial arrangements"), the application of the "old reserves" doctrine derived from Art. 21(2) of the VStG hardly complies with the EC principle of proportionality. National administrations and courts are, however, reluctant to admit that a domestic tax law provision is contrary to a treaty provision.[136]

3.6.3.5. *Abuse of rights doctrine*

In addition to the bilateral beneficial ownership concept, the principle of prohibition of abuse of rights (*Verbot des Rechtsmissbrauchs*) may counteract treaty shopping in that "wholly artificial arrangements", "artificial tax avoidance schemes" and extreme cases of abuse of rights are excluded from the benefits provided for in tax treaties and Art. 15 of the ZBstA.[137] The influence of EC law on Swiss tax law is an opportunity to discard the unsuitable subjective element of the judicial anti-abuse doctrine in Swiss tax law (see 2.1.3.). In Swiss scholarly writing, it has been pointed out that, methodically, there is only the objective question of whether or not tax consequences arise because the facts that give rise to a tax liability are met.[138] Apparently, the FTA has taken this step under Art. 15 of the ZBstA. Specifically, in its Guidelines on Art. 15(1) of the ZBstA of 15 July 2005, the FTA announced that the bilateral beneficial ownership requirement and the principle of prohibition of improper tax abuse (*Verbot der rechtsmissbräuchlichen Steuerumgehung*) apply.[139]

The principle of prohibition of improper tax abuse that applies in the absence of an anti-abuse provision is derived from the principle of the prohibition of abuse of rights in Art. 2(2) of the Swiss Federal Civil Code of 10 December 1907 (*Zivilgesetzbuch*). This contains the principle of good faith.[140] According to the case law of the Federal Supreme Court, an abuse of rights exist, in particular, if a right is inappropriately used to realize interests where the right is not to protect those interests.[141] A more detailed two-step abuse-of-rights test was suggested by the Advocate General in the *Halifax* case (see 3.6.2.3.). In the author's view, this can be transposed to income tax. According to the Advocate General's abuse-of-rights test, Swiss courts must establish whether or not the purpose of Art. 15 of the ZBstA would be achieved if the right to full relief were recognized as being available to taxpayers in the circumstances in which it is claimed.[142] Considering that

133. Id., Para. 3.
134. Id.
135. See Kolb and Waldburger, note 41, slide 4, p. 2.
136. Within the context of source taxation of resident foreign employees without a residence permit to stay permanently in Switzerland (residence permit "C"), August Reimann and Ferdinand Zuppinger took the view that the principle of non-discrimination in Art. 24(1) of the OECD Model must be interpreted in the same way as the principle of equal treatment under the Federal Constitution (August Reimann, "Die Quellensteuer für erwerbstätige Ausländer", 67 *Zentralblatt für Staats- und Gemeindeverwaltung* (1966), p. 100 and Ferdinand Zuppinger, "Einige grundsätzliche Gedanken zur zürcherischen Quellensteuer, 22 *SteuerRevue* (1967) pp. 240-248, p. 241). See also the Commission of Appeal in Federal Direct Tax Matters of the Canton Zurich, 21 December 1988, *Der Steuerentscheid* (1989) B 81.4 No. 1 regarding the questions of whether or not the source taxation procedure for foreign employees residing in the Canton Zurich without a residence permit "C" complies with Art. 25(1) of the Germany–Switzerland tax treaty and the Federal constitutional principle of equal treatment (both questions were left open) and the Court of Appeal of the Canton Zurich, 3 March 1992, *Zürcher Steuerpraxis* (1992), pp. 135-142, regarding the compatibility of the source taxation procedure for foreign employees residing in the Canton Zurich without a residence permit "C" with the principle of non-discrimination in Art. 24(1) of the Japan–Switzerland tax treaty and the Federal constitutional principle of equal treatment. Regarding EC law, the Federal Government takes the view that the principle of non-discrimination in Art. 21(2) of the Free Movement Agreement is somewhat ("*etwas*") more strict than the non-discrimination clause in Art. 24(1) of the OECD Model and, therefore, that that extension will not have far-reaching consequences and, as such, an adjustment to Swiss income tax law is unnecessary. See Federal Government, Technical Explanations of 23 June 1999, Para. 274.32. See also Andreas Kolb, "Bilaterale Verträge I – Personenfreizügigkeit/Grenzgängerbesteuerung", *IFF Forum für Steuerrecht* 1 (2004), p. 30. In addition, see the cases of the European Court of Human Rights against Switzerland regarding the violation of the right to a fair trial enshrined in Art. 6 of the Convention of 4 November 1950 for the Protection of Human Rights and Fundamental Freedoms, i.e. 3 May 2001, *J.B. v. Switzerland*; 29 August 1997, *A.P., M.P. and T.P. v. Switzerland*; and, 29 August 1997, *E.L., R.L. and J.O.-L. v. Switzerland*.
137. In addition, Art. 15(1) and (2) of the ZBstA include subject-to-tax clauses and a two-year holding period requirement (see 3.3.1. and 3.4.1.).
138. Böckli, note 19, p. 292.
139. FTA Guidelines on Art. 15(1) of the ZBstA of 15 July 2005, Para. 10.
140. Id., Para. 10. See Ernst Höhn and Robert Waldburger, *Steuerrecht, Band I*, ninth edition (Bern: Haupt, 2001), Sec. 5, Para. 84 and Böckli, note 19, p. 297. The abuse-of-rights doctrine is also a principle of international law. See Matteotti, note 30, p. 345.
141. "*Das Rechtsmissbrauchsverbot … untersagt die zweckwidrige Verwendung eines Rechtsinstitutes zur Verwirklichung von Interessen, die dieses Rechtsinstitut nicht schützen will.*" ("The prohibition of the abuse of rights is designed to prevent anyone from using his rights in an inappropriate manner for the furtherance of interests, the protection of which is not intended by the legal remedy in question."). See, for example, Federal Supreme Court, BGE 121 II 5, Para. 3(a) and BGE 110 Ib 332, Para. 3(a).
142. *Halifax*, note 116, Para. 91.

the purpose of Art. 15 of the ZBstA is the avoidance of international juridical double taxation, in the author's view, the purpose test should be linked to potential rather than actual double taxation. The subject-to-tax clauses of Art. 15(1) and (2) of the ZBstA must, however, be met, under which all companies must be subject to corporation tax without being exempt, in particular, in respect of interest and royalties. The Swiss courts must also determine whether or not the economic activities carried out by the persons concerned are directed towards anything other than the creation of treaty relief.[143] The Advocate General noted that, in considering the transaction, it is necessary to consider the transaction objectively, as opposed to the intention of the persons concerned carrying out the transaction.[144] If both objective elements are present, it must be concluded that Art. 15 of the ZBstA does not confer treaty relief. If, however, there are objective explanations for entering into the transactions other than those solely to create the right to the treaty relief, abuse of rights must be refused.

In the author's view, a strict interpretation of the principle of the prohibition of improper tax abuse in the Advocate General's abuse-of-rights test remains within Switzerland's margin of discretion under Art. 15 of the ZBstA and denies the unsuitable requirement "*dolus malus contra fiscum"* of the judicial anti-abuse doctrine in Swiss tax law.[145] Similarly, Millet LJ in *Ingram and anor v. IRC* held that:

> What is required to enable the court to disregard a transaction or step in a transaction is not the presence of a tax avoidance motive, but the absence of any other purpose. This is often described as the absence of any business purpose; but in this context the business purpose does not mean commercial purpose but simply non-fiscal purpose.[146]

3.7. Transitional provisions

Art. 15 of the ZBstA applies in respect of Spain from the entry into force of a bilateral agreement between Spain and Switzerland on the exchange of information on request in cases of tax fraud or similar situations regarding income not subject to that agreement, but covered by a tax treaty between Spain and Switzerland. Consequently, the application of Art. 15 of the ZBstA is subject to the condition that bilateral negotiations between Switzerland and Spain under the MoU are successfully concluded and enter into force. An amendment to the Spain–Switzerland tax treaty was signed on 27 April 2005. At the time of writing, it was anticipated that this would enter into force in 2006.

4. CONCLUSIONS

Art. 15 of the ZBstA neither extends the territorial scope of the EC Parent-Subsidiary and the Interest and Royalties Directives to the territory of Switzerland nor provides for straightforward measures following Art. 10 to Art. 12 of the OECD Model. Instead, Switzerland has requested the inclusion of measures "equivalent" to the regimes in the EC Parent-Subsidiary and the Interest and Royalties Directives. The interpretation in good faith and the context in which Art. 15 of the ZBstA was adopted require that the relevant ECJ case law before and after the date of the signature of the ZBstA must be taken into account, insofar as the application of the ZBstA involves concepts and terms in the EC Parent-Subsidiary and the Interest and Royalties Directives.

Art. 15 of the ZBstA significantly reduces the necessity for EC sub-holding and finance companies that have access to the benefits of the EC Parent-Subsidiary and the Interest and Royalties Directives. As royalties and interest paid on intercompany loans are generally not subject to Federal withholding tax, provided that the loans do not qualify as bonds or domestic bank deposits, Art. 15(2) of the ZBstA has no significant effect on Swiss international tax law in the outbound context. The tendency in Swiss treaty practice, under which rates for intercompany dividends in tax treaties concluded between Switzerland and the Member States are lowered to zero, subsequently reduces the effect of Art. 15(1) of the ZBstA.

Finally, the effect of Art. 15 of the ZBstA on Swiss international tax law primarily depends on the Swiss acceptance of ECJ case law, in particular regarding the strict interpretation of the EC principle of proportionality within the context of Swiss bilateral and domestic anti-abuse measures. Under the *Leur-Bloem* ("general anti-abuse rules") and the *Eurowings* and *ICI* cases ("wholly artificial arrangements"), the application of the "old reserves" doctrine derived from Art. 21(2) of the VStG hardly complies with the EC principle of proportionality.

143. Id., Para. 95.
144. Id., Para. 69.
145. See Böckli, note 19, pp. 293 and 305, who denies the subjective element.
146. *Ingram and anor v. IRC*, *Simon's Tax Cases* [1997], p. 1270.