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by Marcel R. Jung

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Swiss tax authorities addressed a number of important issues in 2006, including mergers and acquisitions, repurchase transactions, and exchange of information.

Mergers and Acquisitions

The M&A market for privately held companies stagnated because of an unfavorable Federal Tribunal ruling (2A.331/2003). On June 13, 2006, the Federal Parliament adopted new rules on indirect partial liquidation. (For prior coverage, see *Tax Notes Int'l*, Aug. 28, p. 719.) A private shareholder is taxed on deemed dividend income if the following requirements are cumulatively fulfilled: (i) a participation of at least 20 percent of the capital of a corporation (ii) was transferred by a private shareholder to a purchaser who holds the participation as business assets, (iii) insofar as within five years after the sale, (iv) in cooperation with the seller, (v) nonoperational assets of the corporation are distributed that existed at the time of the sale and could have been distributed in accordance with Swiss company law (retained profits). According to proposed Circular No. 14, the 20 percent threshold test may also be fulfilled if minority shareholders tender their shares under a public tender offer.

The new rules abolished the unfavorable Federal Tribunal ruling according to which a debt-financed acquisition may trigger an indirect partial liquidation to the disadvantage of the private shareholder insofar as future profits of the corporation are distributed and used by the acquirer for interest and redemption payments. The old rules favored sales to financially strong foreign companies.

For federal income tax purposes, the new rules are applicable with retroactive effect to January 1, 2001, when an assessment has not yet entered into force. However, for cantonal and communal income tax purposes, the new rules will enter into force on January 1, 2008.

Securities Lending and Repo Transactions

The Federal Tax Administration published on September 1, 2006, Circular No. 13 on sales-and-leaseback (SLB) and repurchase transactions. The circular addresses Swiss federal withholding tax, foreign withholding tax relief, Swiss federal stamp duty, and Swiss federal income tax issues. The new rules became immediately effective on publication, subject to a transitional period until January 1, 2007. The circular is aimed at avoiding the improper use of tax benefits and the multiple application of relief from Swiss and foreign withholding and other tax relief in connection with SLB and repo transactions.

The circular maintains a system of dual Swiss withholding tax and dual tax reclaim possibility for all long borrowing transactions in Swiss securities, the income of which is subject to Swiss federal withholding tax, when the borrower is a Swiss resident. In fact, the dual system already existed for Swiss banks. Its scope has now been extended to all Swiss resident borrowers.

Accordingly, not only the Swiss issuer (or its paying agent) of the underlying security has to withhold 35 percent tax and issue a withholding tax voucher regarding the original payment of dividend or interest, but also the Swiss resident borrower of the securities again has to withhold 35 percent Swiss federal tax (the "secondary" withholding tax) from the compensation payment, which is calculated based on the original taxable payment.

The Swiss resident borrower will issue a similar withholding tax voucher to the lender, which will enable the lender to reclaim the secondary withholding tax from the Federal Tax Administration in accordance with the Swiss domestic or treaty provisions applicable to it.

The circular is fundamentally changing the withholding tax voucher system, as far as vouchers are issued by Swiss resident persons. Swiss resident issuers of withholding tax vouchers will now be required to report compensation payments (*Ausgleichszahlungen*) as such, to prevent the vouchers from being used by the recipients as documents supporting a withholding tax reclaim or an income tax relief, as the case may be. In the past, the nondistinction between original and compensation payments has often led to multiple withholding tax reclaims for the same payment of dividend or interest, which was effectively subject to withholding tax only once.

Information Exchange and Tax Fraud

Under the memorandum of understanding accompanying the Switzerland-EC savings tax agreement of October 26, 2004, Switzerland has agreed to enter into bilateral negotiations with each EU member state with a view to including in the double tax treaties an exchange of information clause regarding tax fraud or "the like" for income not subject to the Switzerland-EC savings tax agreement. This Swiss obligation complies with the new Swiss treaty policy as laid down in paragraph 24 of the OECD commentary on article 26 as it reads since July 15, 2005.

On June 29, 2006, Switzerland and Spain signed an amending protocol to the double tax treaty of April 26, 1996. (For prior coverage, see *Tax Notes Int',* Nov. 6, 2006, p. 439.) A new article 25 *bis* provides for an exchange of information according to which the competent authorities of the contracting states will exchange, on request, such information as is necessary for carrying out the provisions of the double tax treaty in relation to the taxes that are the subject of the double tax treaty.

Furthermore, they will exchange, on request, any information necessary for the administration or enforcement of the domestic laws in the case of holding companies, in relation to taxes that are the subject of the double tax treaty. Only information may be exchanged that is in possession of the tax authorities and that does not necessitate specific investigation measures.

Finally, they will exchange, on request, any information necessary for the administration or enforcement of the domestic laws in cases of tax fraud or the like that has been committed by a resident of a contracting state or by a person subjected to a limited tax liability in a contracting state, in relation to taxes that are the subject of the double tax treaty. In cases of tax fraud or the like, the provisions will not be construed so as to permit a contracting state to decline to supply information solely because the information is held by a bank, other financial institution, nominee, or person acting in an agency or a fiduciary capacity, or because it relates to ownership interests in a person.

The term "tax fraud" means fraudulent conduct that is deemed to be an offense under the laws of both states and is punishable by imprisonment either when the fraud was committed or when the request was submitted. A protocol contains further comments on the phase "tax fraud or the like."

The amending protocol is still subject to Swiss parliamentary approval. The new rules of article 25 *bis* are similar to those provided for in article 26(1) of the double tax treaty with the United States and article 26 of the double tax treaty with Germany. Switzerland has recently agreed to similar rules with Austria, Finland, United Kingdom, and Norway, and will soon pursue similar agreements with other EC or EFTA member states.

Information Exchange With U.S.

On August 10, 2006, the Federal Tribunal decided a case under article 26(1) of the U.S. income tax treaty (2A.608/205). In that case, a Swiss bank, on request of the Federal Tax Administration, provided the requested information, including a copy of the commercial register extract of X Establishment (Vaduz, Liechtenstein), a list of the account signatories, and the Form A (bank's identification of the beneficial owner). The Form A disclosed that one of the two U.S. persons was the beneficial owner of the account held in the name of X Establishment. The Federal Tax Administration approved the information request of the U.S. Internal Revenue Service and shipped the documents received, including the bank information, to the IRS.

The Federal Tribunal held in favor of the Federal Tax Administration and confirmed that the acts allegedly committed by the U.S. persons constituted tax fraud in the meaning of the U.S. income tax treaty (fraudulent conduct designed to deceive the fiscal authorities).

European Tax Law

The agreement of June 21, 1999, on the free movement of persons between Switzerland and the EC and its member states (AFMP) generally extends the freedom of workers in article 39, the right of establishment in article 43, and the freedom to provide services in article 49 of the EC Treaty to the territory of Switzerland. The freedom to provide services seems to be limited to a duration not exceeding 90 days of actual work in a calendar year.

The right of establishment of companies in articles 43 and 48 and the freedom of capital in article 56 of the EC Treaty are not included in the AFMP. Therefore, the case law of the ECJ regarding the freedom of establishment of companies, in particular *Marks & Spencer* (Case C-446/03) and *Cadbury Schweppes* (Case C-196/04), is not applicable in relations to Switzerland. However, there are pending cases under the freedom of capital in relation to third countries according to article 56 of the EC Treaty. In the pending *Holböck* case (C-157/05), the question has arisen whether the rejection of Austrian shareholder relief for Swiss-source dividends constitutes a prohibited discrimination. This question was already ruled within the EC context in the *Lenz* case (C-315/02). In the pending *Lasertec* case (C-492/04), the question has arisen whether Swiss loans are discriminated under the former German thin cap rules. The same question was at issue in the *Lankhorst-Hohorst* case (Case C-324/00). *Skatteverket v. A* (C-101/05) is another case pending on the rejection of an exemption for dividends in the form of shares in a Swiss subsidiary. ◆

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