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Trends and Developments in Swiss Anti-Treaty Shopping Legislation and Treaty Shopping Case Law

The author highlights the trends and developments in Swiss anti-treaty shopping legislation and treaty shopping case law. He exposes the standard cases of improper use of tax treaties from a Swiss withholding tax perspective. He further analyses the relationship between unilateral anti-avoidance measures and treaty law and explores the scope and limits of the unilateral judicial tax avoidance and abuse of rights doctrines. He then analyses the recent case law of the Federal Tribunal and the Federal Administrative Court.

1. Introduction

1.1. Interpretation that departs from the text of a legal norm

In regard to counteracting the improper use of Swiss tax treaties, two trends may be identified. One trend, which may be regarded as *internally* triggered, consists of the development of law by the Federal Tribunal based on the principle of interpretation that a treaty term shall take into account, in addition to the text, what the contracting parties might understand the purpose of the treaty to be in accordance with the principle of good faith. This development of the law resulted in the decision of 28 November 2008 in the matter *A. Holding ApS*, a decision of the highest court wherein the question of substance of a company resident in a foreign contracting state was no (longer) answered based on the criteria of the tax avoidance intention (*Steuerumgehungsabsicht*)[1] or beneficial ownership (*Nutzungsberechtigung*),[2] but based on a prohibition of abuse of rights (*Verbot des Rechtsmissbrauchs*).[3]

In recent years, letter-box and holding companies without substance have been used in order to obtain a refund of the Swiss dividend withholding tax for the benefit of foreign persons that are not subject to treaty protection. Furthermore, other more aggressive tax avoidance techniques have been used that involve concluding derivative financial instruments with unrelated persons resident in a contracting state (through the use of a tax treaty) or in Switzerland (without the use of a tax treaty). Such structures rely on the understanding that the interpretation of a tax treaty term is governed only by the ordinary meaning to be given to the terms of the treaty.

The "Wall Street Rule" is, in particular, known in the Anglo-Saxon financial industry.[4] One version of this rule is that the tax authorities cannot challenge the tax treatment of a security or transaction if there is a long-standing and generally accepted understanding of its expected tax treatment (the golden oldie version). The second version of the Wall Street Rule is that the tax authority is deemed to have acquiesced in the tax treatment of any security or transaction if the dollar amount involved is of a sufficient magnitude. This version of the Wall Street rule is primarily premised on the dollars involved and the adverse economic or market impact of any challenge by the tax authority (the golden rule version). At the TEI/LMSB Financial Services Industry Conference on 22 September 2003, Emily A. Parker, Acting Chief Counsel, IRS, recalled that: "As a legal matter, there is no such thing as The Wall Street Rule."

In this spirit, the Federal Tax Administration has countered such developments by tightening the refund practice, in order to combat the improper use of tax treaties, through reliance on the (unwritten) tax treaty requirement of beneficial ownership (development of law *praeter verba legis*). Furthermore, in its decision of 28 November 2005, in the matter *A. Holding ApS*, the Federal Tribunal referred to an (unwritten) treaty principle that prohibits treaty abuse (*Verbot des Abkommensmissbrauch*), which can be derived from Art. 31(1) of the Vienna Convention on the Law of Treaties (Vienna Convention) (development of law *contra verba legis*).[5]

There is also a trend in the Federal Administrative Court's case law to interpret autonomous treaty terms in accordance with case law on unilateral law and, as a consequence, to give the unilateral law an indirect international effect. In its decision of 30 October 2008 in *A. GmbH*, the Federal Administrative Court interpreted the treaty term "beneficial ownership" in accordance with Art. 21(1)(a) of the Federal Withholding Tax Act (WTA) and the (unwritten) treaty principle of prohibition of treaty abuse that the Federal Tribunal derived from Art. 31(1) of the Vienna Convention, in accordance Art. 21(2) of the WTA.[6] In order for a refund of the federal dividend

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1. Federal Tribunal, 9 November 1984, *Y. B.V.*, BGE 110 Ib 287 = ASA 54 (1985/86), pp. 64-74.
2. Federal Commission of Appeal in Tax Matters, 28 February 2001, *V. S.A.*, SRK 2000-055 = VPB 65.86 = ITLR 4 (2002), pp. 191-214.
3. Federal Tribunal, 28 November 2005, *A. Holding ApS*, 2A.239/2005 = ITLR 8 (2006), pp. 536-562.
4. E.A. Parker, TEI/LMSB Financial Services Industry Conference, 22 September 2003, pp. 1-7.
5. *A. Holding ApS*, note 3, pp. 536-562.
6. Federal Administrative Court, 30 October 2008, *A. GmbH*, A-2163/2007.

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withholding tax to be made to a Swiss resident shareholder, the shareholder must be the beneficial owner of the dividends received (Art. 21(a)(a) of the WTA) and no tax avoidance must be present (Art. 21(2) of the WTA). This indirect international effect of the unilateral judicial tax avoidance doctrine, which is stipulated in Art. 21(2) of the WTA, was confirmed by the Federal Administrative Court in its decision of 23 March 2010 in *X. GmbH*.[7]

1.2. Stipulation of bilateral anti-avoidance provisions

At the same time, an opposing *externally* triggered trend has emerged under Swiss treaty practice. Swiss treaty policy has traditionally not stipulated specific anti-avoidance provisions in Swiss tax treaties. Only a few Swiss leading cases on the interpretation of bilateral anti-avoidance provisions, therefore, exist.[8]

Since the conclusion of the Switzerland–EC Savings Tax Agreement (STA) on 26 October 2004 and its withdrawal of the reservation to Art. 26 of the OECD Model on 13 March 2009, Switzerland has revised or negotiated a number of tax treaties with important contracting states and thereby has revised or introduced several anti-avoidance provisions under Swiss treaty law. In recent years, upon the request of foreign contracting states, specific treaty provisions have increasingly been agreed to in Swiss tax treaties that are directed, in particular, against conduit companies. One standard form of these bilateral anti-avoidance provisions is a UK style transaction-based anti-avoidance clause (*conduit clause*) that was originally introduced in Swiss treaty law by Arts. 3(1)(l), 10(6), 11(7), 12(5) und 21(4) of the United Kingdom–Switzerland tax treaty (1977) (as it reads following the protocol of 26 June 2007, in force since 22 December 2008). Another is a US style entity-based anti-avoidance clause (*look through clause*). This type of clause was originally introduced by Art. 11(2)(b)(ii) of the France–Switzerland tax treaty (1966) (as it read following the protocol of 22 July 1997 and prior to the protocol of 27 August 2009, which was repealed on 4 November 2010) and by a highly complex limitation of benefits clause in Art. 22 of the United States–Switzerland tax treaty (1996).

In recent years, specific treaty provisions have also been agreed to in Swiss tax treaties that expressly allow for the application of unilateral anti-avoidance provisions and jurisprudential rules.[9] This trend was obviously triggered by the 2003 Update to the OECD Commentary, as well as an academic dispute concerning two questions of principle:[10] (1) are unilateral anti-avoidance and jurisprudential rules applicable in the treaty context and (2) is there an (unwritten) treaty principle of prohibition of treaty abuse?

1.3. EU tax law

There is an increasing influence of EU law on Swiss tax law, pursuant to which specific treaty terms and even unilateral tax provisions are not interpreted in accordance with the OECD Commentaries, but in light of ECJ case law. Under the influence of EU tax law, Switzerland has agreed to specific minimum holding period clauses in the context of the inter-company treaty relief provision that have to be interpreted in accordance with ECJ case law (*Denkavit II*).[11,12]

It its decision of 26 January 2010 in the matter *X.*, the Federal Tribunal held that the refusal to grant specific allowances to a non-resident taxpayer violated the non-discrimination principle as laid down in the Switzerland–EC Agreement on the Free Movement of Persons (AFMP) and interpreted the unilateral tax provisions in accordance with ECJ case law, introducing the *Schumacker* formula into Swiss international tax law.[13] In its decisions, the Federal Tribunal goes even further than Art. 16(2) of the AFMP requires. For example, the court stated, in its decision of 4 November 2003 in the matter *A. und B.* regarding the family reunification provisions, that it is not bound by ECJ case law decided after the date of signature of the AFMP, namely 21 June 1999. Nevertheless, it could take into account such case law in interpreting the provisions of the AFMP.[14]

1.4. Principle of common interpretation

According to the principle of common interpretation, courts and administrations of a contracting state shall take into account decisions of the other contracting state, as well as decisions of third states, in interpreting treaty

7. Federal Administrative Court, 23 March 2010, *X. GmbH*, A-2744/2008.
8. See *Y. B.V.*, note 1, pp. 64-74 regarding Art. 9(2)(a)(i) of the Switzerland–Netherlands tax treaty (1951) (as it read after the protocol of 22 June 1966, will be repealed by the Switzerland–Netherlands tax treaty (2010) (not yet in force); Federal Tribunal, 16 August 1996, *S. AG*, ASA 66 (1997/98), pp. 406-416 regarding Art. VI(2) of the Switzerland–United States tax treaty (1951) (repealed on 19 December 1997); *V. S.A.*, note 2, pp. 191-214 regarding Art. 10(2)(a)(i) and (b) of the Switzerland–Luxembourg tax treaty (1993) (as it read before the protocol of 25 August 2009, in force since 19 November 2010).
9. See Art. 23(1) of the Switzerland–Germany tax treaty (1971) (as it reads following the protocol of 12 March 2002, in force since 24 March 2003), Para. 8 of the Protocol to the Switzerland–Israel tax treaty (2003) and Para. I(i) of the Protocol to the Switzerland–Spain tax treaty (1966) (as it reads following the protocol of 29 June 2006, in force since 1 June 2007).
10. See Stef van Weeghel, General Report, Tax Treaties and Tax Avoidance, "Application of Anti-avoidance Provisions", *Cahiers de droit fiscal international*, Vol. 95a, IFA Congress 2010 Rome (The Hague: International Fiscal Association, 2010), pp. 17-55.
11. ECJ, 14 December 2006, Case C-170/05, *Denkavit Internationaal BV, Denkavit France SARL v. Ministre de l'Économie, des Finances et de l'Industrie*.
12. See Arts. 10(2)(b) and 12(7) of the Switzerland–Spain tax treaty (1966) (as it reads following the protocol of 29 June 2006, in force since 1 June 2007), Art. 10(2)(b)(i) of the Switzerland–Luxembourg tax treaty (1993) (as it read following the protocol of 25 August 2009, in force since 19 November 2010), Art. 10(2a)(i) of the Switzerland–Poland tax treaty (1991) (as it reads following the protocol of 20 April 2010 (not yet in force). In contrast to the author's view, it seems that according to the federal administrative practice, the *Denkavit* formula is not applicable to Art. 10(2)(b) of the Switzerland–Spain tax treaty (1966) (as it reads following the protocol of 29 June 2006, in force since 1 June 2007) even though this inter-company treaty relief provision originates from the Parent-Subsidiary Directive (90/435/EC) and, according to "III. To Article 10(2)(b) and Article 12(7)" of the Protocol to the Switzerland–Spain tax treaty (1966), the meaning of the terms used in Art. 10(2)(b) are governed by the Parent-Subsidiary Directive.
13. Federal Tribunal, 26 January 2010, *X.*, 2C_319/2009 and 2C_321/2009, Para. 11.3. See Marcel R. Jung, "The Switzerland–EC Agreement on the Free Movement of Persons: Measures equivalent to those in the EC Treaty – A Swiss Income Tax Perspective", *European Taxation* 11 (2007), pp. 508-528: Reto Heuberger and Stefan Oesterhelt, "Swiss Salary Withholding Tax Violates Free Movement of Persons Agreement with the European Union", *European Taxation* 7 (2010), pp. 285-294.
14. Federal Tribunal, 4 November 2003, *A. und B.*, BGE 130 II 1, Para. 3.6.1.

provisions based on the OECD Model. In the last two decades, this principle has attracted increasing attention in the international literature, in particular, due to improved access to foreign court decisions. For example, they are reprinted in Philip Baker's *International Tax Law Reports* in the original language and also in English.

The principle of common interpretation had already been mentioned by the OECD Fiscal Committee in Para. 5 of the Introduction to the 1977 OECD Model: "harmonization of these conventions in accordance with uniform principles, definitions, rules, and methods, and agreement on a common interpretation, became increasingly desirable."

Philip Baker is one of the most prominent advocates of this principle and suggests that:[15]

> [...] courts should consider and, preferably, follow relevant decisions from other states unless they are convinced that those decisions are incorrect [...] provisions in treaties based upon the OECD Model should, so far as possible, be given a uniform interpretation in all countries.

In its decision of 18 December 1940 regarding the Switzerland–Germany tax treaty (1932), the Federal Tribunal held that one must not take into account whether the jurisdiction of the other contracting state stands on a different ground.[16] Locher and Waldburger noted, as early as 1993 and 1998, that the principle of common interpretation is not yet generally accepted in Switzerland and that Swiss courts refrain from referring to foreign cases.[17]

Due to Switzerland's access to the common market by virtue of the bilateral agreements, the principle of common interpretation has become a specific legal basis under Swiss international law. Pursuant to Art. 16(2) of the AFMP, account shall be taken of the relevant case law of the ECJ prior to the date of signature of the AFMP insofar as the application of the AFMP involves concepts of EU law. Case law decided after that date shall be brought to Switzerland's attention. To ensure that the AFMP works properly, a Joint Committee determines the implications of such case law.

The Federal Tribunal referred, in its decision of 28 November 2005 in the matter *A. Holding ApS*, concerning the interpretation of Art. 10(1) of the Switzerland–Denmark tax treaty (1973) (as it read before the protocol of 21 August 2009, which has been in force since 22 November 2010), to its previous case law, according to which the interpretation of a treaty term shall take into account, in addition to its text, how the contracting parties might have understood the *purpose* of the treaty in accordance with the principle of good faith, unless the judge can derive a different contractual intention of the contracting parties from its origin. Both the context of the treaty provision and its object and purpose play a role in the interpretative process. Good faith, as well as the object and purpose, have to be taken into account for each interpretation of a treaty provision.[18] Referring to Art. 26 of the Vienna Convention, the Federal Tribunal held that each contracting state may expect from the other that the principle *pacta sunt servanda*, referred to therein, will be observed. On the one hand, the court referred to its decision of 19 December 2003 in the matter *X.*, regarding the family reunification provisions of the AFMP, wherein it also took into account ECJ case law.[19] On the other hand, the court referred to the decisions of 26 July 2000 in the matter *N. AG* and of 9 December 2004 in the matter of *IFSC Dublin Docks* of the Austrian Administrative Court and, therefore, to case law of a third state.[20]

There is a trend in the jurisprudence of the Federal Tribunal to take into account leading foreign cases in interpreting treaty provisions. This trend has obviously accelerated as a result of the conclusion of the bilateral agreements with the European Union. The principle of common interpretation has become an aid to interpretation in the Federal Tribunal's case law that has gained importance in recent years. Even though this principle, as well as the OECD Commentary as an aid to interpretation of treaty provisions, cannot be easily assigned to one of the aids to interpretation in Arts. 31–33 of the Vienna Convention, one can hardly dispute decisions of the Federal Tribunal that use the principle of common interpretation and the OECD Commentary as an aid to interpretation. The Federal Tribunal derives the principle of common interpretation from the general rule of interpretation of international treaties, which provides that treaties are to be interpreted in good faith, stipulated in Art. 31(1) of the Vienna Convention. In this spirit, in the author's view, in interpreting Art. 15 of the STA, ECJ case law should be taken into consideration to the extent that Art. 15 of the STA addresses terms and concepts relating to EU law, in particular, concepts that derive from the Parent-Subsidiary Directive and Interest and Royalties Directive, irrespective of whether the respective ECJ case law was decided prior to or after the date of its signature.[21]

In its decision of 30 October 2008 in the matter of *A. GmbH* regarding the Switzerland–Germany tax treaty (1971), the Federal Administrative Court gave the unilateral beneficial ownership requirement in Art. 21(1)(a) of the WTA an indirect international effect in the treaty context.[22] It held that the treaty term "beneficial ownership"

15. Philip Baker, *Double Tax Conventions and International Tax Law*, 3rd. ed. (London: Sweet & Maxwell, 2005, loose-leaf), E.26; See David A. Ward, "Use of foreign court decisions in interpreting tax treaties", in Guglielmo Maisto, *Courts and Tax Treaty Law* (Amsterdam: IBFD, 2007), pp. 161-188; Jonathan Schwarz, *Schwarz on Tax Treaties* (London: CCH, 2008), p. 78 et seq.
16. Federal Tribunal, 18 December 1940, *Aluminium-Industrie A.-G.*, BGE 66 I 265, Para. 1.
17. Peter Locher, Swiss Branch Report, "Interpretation of Double Taxation Conventions", *Cahiers de droit fiscal international*, Vol. 78a (Deventer: Kluwer, 1993), pp. 573-595, at p. 586; Robert Waldburger, "Die Auslegung von Doppelbesteuerungsabkommen in der Rechtsprechung des Schweizerischen Bundesgerichts", in Michael Lang, Jörg Manfred Mössner and Robert Waldburger (eds.), *Die Auslegung von Doppelbesteuerungsabkommen* (Vienna: Linde, 1998), pp. 53-116, at p. 57 et seq.
18. *A. Holding ApS*, note 3, pp. 536-562, Para. 3.4.2. and 3.4.3.
19. Federal Tribunal, 19 December 2003, *X.*, BGE 130 II 113, Para. 6.1.
20. Administrative Court, 26 July 2000, *N. AG*, 97/14/0070; ITLR 2 (2000), pp. 884-901; Administrative Court, 9 December 2004, *IFSC Dublin Docks*, 2002/14/0074.
21. See Marcel R. Jung, "Article 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", *European Taxation* 3 (2006), pp. 112-126.
22. *A. GmbH*, note 6, Para. 7.

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has an autonomous meaning, but is linked to the case law on Art. 21(1)(a) of the WTA and unilateral law respectively. The autonomous interpretation is based on the principle of common interpretation. In order to establish the autonomous meaning of the treaty term "beneficial ownership", the court must follow a complex interpretation process. In this regard, the two leading cases of international tax law, *Indofood* and *Prévost*, may be taken into account.[23] The Federal Administrative Court, however, did not make any attempt – in contrast to the Federal Commission of Appeal in Tax Matters in its case of 28 February 2001 in the matter of *V. S.A.*[24] – to interpret the treaty term "beneficial ownership" autonomously, and, instead, referred directly to the case law on unilateral law.

2. Improper Use of Tax Treaties

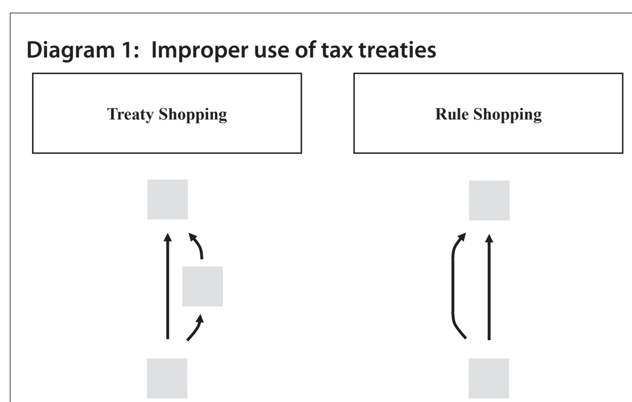
2.1. Abusive avoidance of a unilateral tax law

It would not be surprising if a foreign non-treaty protected person deriving Swiss-source income that is subject to Swiss withholding taxation were tempted to abusively use a tax treaty concluded between Switzerland and a foreign contracting state in order to obtain a full or partial refund of the Swiss withholding tax (abusive use of a tax treaty relief provision).

In light of the international doctrine, the following two standard types of improper use of a tax treaty may be distinguished:

- Treaty Shopping: a foreign person, who is resident in a contracting state or a third state and derives Swiss-source income that is subject to Swiss withholding tax, obtains treaty benefits through the interposition of a person resident in a contracting state (for example, a holding company resident in a contracting state). Treaty benefits are requested based on a tax treaty that was not applicable prior to the abusive arrangement.
- Rule Shopping: a foreign person who is resident in a contracting state and derives Swiss-source income that is subject to Swiss withholding tax obtains treaty benefits through the conversion of this income into income that is not subject to or is subject to a lower Swiss withholding tax (for example, interest bearing loans, non- traditional derivative financial instruments, the interposition of a holding company resident in the same contracting state, or the sale of a participation just prior to the dividend due date). Treaty benefits are requested based on a tax treaty that was applicable prior to the abusive arrangement. The request, however, is based on a different treaty provision. The conversion of income may also be arranged through the interposition of a person resident in Switzerland so that relief from Swiss withholding tax is – at the same time as the request under the tax treaty – also requested based on the unilateral tax law of Switzerland.

Diagram 1: Improper use of tax treaties



When Treaty Shopping is present, a foreign person who is resident in a contracting state or a third state and derives Swiss-source income buys into a tax treaty concluded by Switzerland through the interposition of a person resident in a contracting state in order to obtain access to the benefits of the tax treaty concluded by Switzerland. In contrast, when Rule Shopping is present, a foreign person who is already resident in the other contracting state and derives Swiss-source income buys into a specific treaty provision of the tax treaty concluded with Switzerland in order to obtain access to a better treaty provision under the tax treaty concluded with Switzerland. Under both typical forms of treaty abuse, the person resident abroad invests indirectly in the Swiss-source income, either indirectly through an intermediary person resident in a contracting state, or indirectly through other Swiss-source income. The abusive use of a tax treaty results, ultimately, in abusive avoidance of a unilateral tax law provision of Switzerland.

According to Para. 7 of the 2003 OECD Commentary on Art. 1 of the OECD Model (corresponding to Para. 7 of the 2010 OECD Commentary on Art. 1 of the OECD Model), the principal purpose of tax treaties is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons. Consequently, there must be a "market-economy connecting factor" between the person who requests relief from source taxes of a contracting state and the other contracting state where the person is resident.

In regard to Treaty Shopping, this connecting factor is typically missing. In contrast, in regard to Rule Shopping there is typically a connecting factor between the person who asks for relief from source taxes of a contracting state and the other contracting state where the person is resident. An arrangement can have features of both Treaty Shopping and Rule Shopping. As a consequence, an exact classification of an arrangement into one of these two categories is not always possible and, from a tax point of view, also not necessary.

23. Court of Appeal, 2 March 2006, *Indofood International Finance Ltd v. JPMorgan Chase Bank NA, London Branch*, [2006] EWCA Civ 158; ITLR 8 (2006), pp. 1-32; Tax Court of Canada, 22 April 2008, *Prévost Car Inc*, 2008 TCC 231; ITLR 10 (2008), pp. 736-771.
24. *V. S.A.*, note 2, pp. 191-214.

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Para. 7 et seq. of the 2003 OECD Commentary on Art. 1 of the OECD Model (corresponding to Para. 7 et seq. of the 2010 OECD Commentary on Art. 1 of the OECD Model) uses the title, "Improper Use of Tax Treaties". In the author's view, this phrase has to be construed such that it refers to the abusive use of a tax treaty, in particular, of a tax treaty relief provision. The OECD Commentary also uses, in Para. 7 of the Commentary on Art. 1 of the OECD Model, the phrase "Tax Avoidance". This term refers to the abusive avoidance of a unilateral tax law provision of a contracting state. "Improper Use of Tax Treaties", "Treaty Shopping", "Rule Shopping" and "Tax Avoidance" are notions used in the international tax law doctrine in order to categorize specific arrangements with identical or similar features and identical or similar effects. However, they are *not* legal norms of a particular legal system that are of a normative character.

2.2. Standard cases

From a Swiss tax treaty point of view, ten standard cases of treaty abuse can be identified in the area of Swiss withholding tax.

Standard case 1 relates to the inbound treaty case of Treaty Shopping where Switzerland is the residence state. A Swiss resident person is established for the purpose of obtaining access to the treaty benefits of the tax treaty concluded between the source state and Switzerland. A Swiss resident person requests relief from foreign source taxes based on a tax treaty concluded between the source state and Switzerland. The treaty relief substantially benefits, directly or indirectly, persons who are not treaty protected. The relief may be related to income, a substantial part of which is used, directly or indirectly, to meet claims of persons who are not treaty-protected (*conduit company*) or benefit a legal entity with its legal seat in Switzerland in which persons who are not treaty protected have a substantial interest, directly or indirectly, whether by way of a participation or otherwise and that abstains from adequate profit distributions (*base company*).

Standard case 2 relates to the outbound treaty case of Treaty Shopping where Switzerland is the source state. The person resident in the contracting state is established for the purpose of obtaining access to the treaty benefits of the tax treaty concluded between the contracting state and Switzerland or the STA. A person resident in a contracting state asks for relief from Swiss-source taxes. The treaty relief substantially benefits, directly or indirectly, persons who are not treaty protected (*conduit company*). This standard case also relates to a more aggressive tax avoidance technique that has emerged in recent years by means of derivative financial instruments with the use of a tax treaty. Swiss assets, such as shares (as a rule, portfolio investments) and bonds are transferred by a foreign person not resident in a contracting state to a *foreign non-related* person resident in a contracting state for the purpose of obtaining access to the treaty benefits of the tax treaty concluded between the contracting state and Switzerland. The transfer results, in the end, in partial or full relief from Swiss withholding taxes levied on dividends or interest based on a tax treaty concluded between the contracting state and Switzerland. The repatriation by the foreign non-related person of the dividends or interest received to the other foreign person is not subject to foreign withholding tax (for example, Swap payments).

Standard case 3 relates to the outbound treaty case of Rule Shopping where Switzerland is the source and the residence state at the same time. A domestic subsidiary is established by a foreign parent company resident in a contracting state for the purpose of obtaining access to the tax benefits of the domestic relief procedure as laid down in the WTA and other treaty relief provisions of the tax treaty concluded between Switzerland and the residence state or the STA. Swiss assets, such as shares (as a rule, portfolio investments) or bonds are transferred by the foreign parent company to the domestic subsidiary (*cross-in*). The group transfer results, in the end, in full relief from Swiss withholding taxes levied on dividends or interest based on the WTA. The repatriation by the domestic subsidiary of the dividends or interest received to the foreign parent company is not subject to Swiss withholding tax (for example, due to an inter-company treaty relief provision provided for in the tax treaty concluded between Switzerland and the residence state of the foreign parent company) or the Swiss withholding tax levied on dividend distributions by the domestic subsidiary is prevented through an accumulation of profits (through interest bearing loans, or a sale of the participation in the domestic subsidiary so that the foreign parent company realizes a capital gain). The foreign parent company converts dividend or interest income falling under Arts. 10(2)(b) and 11 of the OECD Model into inter-company dividends falling under Art. 10(2)(a) of the OECD Model or a capital gain falling under Art. 13(5) of the OECD Model. Therefore, this standard case may be characterized as Rule Shopping.

Standard case 4 also relates to the outbound treaty case of Rule Shopping where Switzerland is the source and the residence state at the same time. A domestic permanent establishment (PE) is established by a foreign company resident in a contracting state for the purpose of obtaining access to the tax benefits of the domestic relief procedure as laid down in the WTA and other treaty relief provisions of the tax treaty concluded between Switzerland and the residence state or the STA. Swiss assets, such as shares (as a rule, portfolio investments) or bonds are transferred by the foreign company to the domestic PE (*cross-in*). The group transfer results, in the end, in full relief from Swiss withholding taxes levied on dividends or interest based on the WTA. The repatriation by the domestic PE of the dividends or interest received to the foreign company is not subject to Swiss withholding tax and typically also not subject to tax in the residence state of the foreign company (for example, due to an exemption method applicable to income of a foreign PE provided for in the unilateral tax law of the residence state of the foreign company). The foreign company converts dividend or interest income falling under Arts. 10(2) and 11 of the OECD Model into income of a PE falling under Arts. 5 and 7 of the OECD Model or other income falling

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under Art. 21(1) of the OECD Model. This standard case may also be characterized as Rule Shopping.

Standard case 5 relates to the *old reserves doctrine* in the outbound treaty case of Treaty Shopping. Switzerland is the source state. A participation in a domestic corporation that has, at the moment of transfer, non-operational assets that are available for distribution, is transferred by a foreign parent company to another foreign group company resident in a contracting state. The purpose of the transfer is to obtain access to the treaty benefits of the tax treaty concluded between Switzerland and the residence state of the acquiring foreign group company or the STA. The transfer results, in the end, in lower non-refundable residual Swiss withholding taxes based on another treaty relief provision (for example, a treaty relief provision that corresponds to Art. 10(2)(a) of the OECD Model).

Standard case 6 relates to the *old reserves doctrine* in the outbound case of Rule Shopping. Switzerland is the source and residence state at the same time. A participation in a domestic corporation that has, at the moment of transfer, non-operational assets that are available for distribution, is transferred by a foreign parent company to a domestic subsidiary (*cross-in*). The group transfer results, in the end, in full relief from Swiss withholding taxes levied on dividends based on the domestic relief procedure as laid down in the WTA. The repatriation by the domestic subsidiary of the dividends received to the foreign parent company is not subject to Swiss withholding tax (for example, due to an inter-company treaty relief provision provided for in the tax treaty concluded between Switzerland and the residence state of the foreign parent company) or the Swiss withholding tax levied on dividend distributions by the domestic subsidiary is prevented through an accumulation of profits (for example, through interest-bearing loans, or a sale of the participation in the domestic subsidiary so that the foreign parent company realizes a capital gain). The purpose of the transfer is to obtain access to the tax benefits of the WTA and other treaty relief provisions of the tax treaty concluded between Switzerland and the residence state of the foreign parent company or the STA. The foreign parent company converts dividend income falling under Art. 10(2)(b) of the OECD Model into inter-company dividends falling under Art. 10(2)(a) of the OECD Model or a capital gain falling under Art. 13(5) of the OECD Model. Therefore, this standard case may be characterized as Rule Shopping.

Standard case 7 also relates to the *old reserves doctrine* in the outbound treaty case of Rule Shopping. Switzerland is the source and residence state at the same time. A participation in a domestic corporation that has, at the moment of transfer, non-operational assets that are available for distribution, is transferred by a foreign company to a domestic PE (*cross-in*). The group transfer results in the end in full relief from Swiss withholding taxes levied on dividends based on the domestic relief procedure as laid down in the WTA. The repatriation by the domestic PE of the dividends received to the foreign company is not subject to Swiss withholding tax. The purpose of the transfer is to obtain access to the tax benefits of the WTA and other treaty relief provisions of the tax treaty concluded between Switzerland and the residence state of the parent company. The foreign company converts dividend income falling under Art. 10(2) of the OECD Model into income of a PE falling under Arts. 5 and 7 of the OECD Model. This standard case may be characterized as Rule Shopping.

Standard case 8 relates to the outbound treaty case of Rule Shopping where Switzerland is the source state. A foreign person resident in a contracting state who derives Swiss-source income that is subject to Swiss withholding taxation converts this income into income that is not subject to Swiss withholding taxation (for example, through interest bearing loans, non-traditional derivative financial instruments, or a sale of a participation just prior to the dividend due date). The purpose of the conversion is to obtain access to other treaty relief provisions of the tax treaty concluded between Switzerland and the residence state. The conversion results, in the end, in lower non-refundable residual Swiss withholding taxes based on another treaty relief provision (for example, a treaty relief provision that corresponds to Arts. 11(2), 13(5) or 21(1) of the OECD Model).

Standard case 9 relates to a specific outbound treaty case of Rule Shopping where Switzerland is the source state. A holding company is established by an individual resident in the same contracting state for the purpose of obtaining access to another treaty relief provision of the tax treaty concluded between Switzerland and the residence state or the STA. An individual person who is resident in a contracting state transfers a participation in a domestic corporation to a holding company resident in the same contracting state. The transfer results, in the end, in lower non-refundable residual Swiss withholding taxes based on the inter-company treaty relief provision (for example, a treaty relief provision that corresponds to Art. 10(2)(a) of the OECD Model).

In addition to Treaty Shopping and Rule Shopping, another aggressive tax avoidance technique has emerged in recent years by means of derivative financial instruments without the use of a tax treaty. *Standard case 10* relates to the outbound non-treaty case where Switzerland is the source and residence state at the same time. Swiss assets, such as shares (as a rule, portfolio investments) or bonds, are transferred by a foreign person that is not treaty protected to a *domestic non-related* person (*cross-in*) for the purpose of obtaining access to the tax benefits of the WTA. The transfer results, in the end, in full relief from Swiss withholding taxes levied on dividends or interest based on the domestic relief procedure as laid down in the WTA. The repatriation by the domestic non-related person of the dividends or interest received to the foreign person is not subject to Swiss withholding tax (for example, Swap payments). The foreign person converts dividend or interest income that is subject to Swiss withholding taxation into tax-free payments. Relief from Swiss-source taxes is requested based on the unilateral tax law of Switzerland in a way such that a unilateral tax law provision is directly – without the use of a tax treaty – avoided (*abusive avoidance of a unilateral tax law provi-*

sion). The conversion of income is not arranged through the interposition of a person resident in a contracting state. Therefore, relief from Swiss withholding tax is not – at the same time as the request under unilateral tax law of Switzerland – also requested based on a tax treaty (*abusive use of a tax treaty relief provision*). The foreign person buys (similar to Treaty Shopping and Rule Shopping) into a relief provision of the unilateral law through the interposition of a person in order to convert dividends or interest subject to Swiss withholding tax to tax-free payments.

2.3. Consequences under Swiss law

The categorization of a particular arrangement as "Improper Use of Tax Treaty", "Treaty Shopping", "Rule Shopping" or "Tax Avoidance", or as a particular standard case, does not trigger tax consequences under Swiss law.

Tax consequences are only triggered based on (1) a particular anti-avoidance provision, (2) a particular jurisprudential rule or (3) a substance-over-form interpretation of the legal norm of a tax law provision (a) of the unilateral law of Switzerland, in particular, the principle of prohibition of abuse of rights (Art. 9 of the Federal Constitution) or the (unwritten) constitutional principle of prohibition of treaty abuse derived therefrom;[25] the general tax avoidance doctrine;[26] 1962 Anti-Abuse Decree;[27] thin capitalization and interest rate rules;[28] or based on (1) a particular anti-avoidance provision, (2) a particular jurisprudential rule or (3) a substance-over-form interpretation of the legal norm of a provision (b) of the bilateral law of Switzerland, in particular, beneficial ownership; an arranged-or-maintained clause; a conduit arrangement clause; a look-through clause; a minimum holding period clause; a limitation on benefits clause; or the (unwritten) treaty principle of prohibition of treaty abuse derived from Art. 31(1) of the Vienna Convention[29] if the arrangement fulfils the requirements of such a provision or jurisprudential rule or a substance-over-form interpretation of the legal norm is applicable.

If relief from Swiss-source taxes is also requested based on the domestic relief procedure as laid down in the WTA, tax consequences may also be triggered based on unilateral anti-avoidance provisions laid down in the WTA (for example, the beneficial ownership requirement in Art. 21(1)(a) of the WTA or the general anti-avoidance provision in Art. 21(2) of the WTA).

3. Relationship between Unilateral Anti-Avoidance Measures and Treaty Law

3.1. Arts. 26 and 27 of the Vienna Convention

In the author's view, it can hardly be consistent with Swiss doctrine, the conclusions of the Federal Commission of Appeal in Tax Matters in its decision of 3 March 2005 in the matter *A. Holding ApS* and the ruling of the Federal Administrative Court in its decision of 23 March 2010 in the matter *X. GmbH*, to conclude that the principle of priority of international law precludes the application of the general anti-avoidance provision in Art. 21(2) of the WTA.[30]

The Federal Commission of Appeal in Tax Matters held, in *A. Holding ApS*, that – in contrast to the view of the Federal Tax Administration – Art. 21(2) of the WTA would not be applicable to relief from Swiss withholding tax in the tax treaty context. In light of the more recent Federal Tribunal's case law it could be stated that the principle of priority of international law could be derived from the nature of the international provision.[31] Switzerland may not circumvent an international obligation with reference to unilateral law. This consideration is obviously derived from Art. 27 of the Vienna Convention, pursuant to which a contracting party may not invoke the provisions of unilateral law as a justification for its failure to uphold a treaty obligation. The Federal Commission of Appeal in Tax Matters concluded that the general anti-avoidance provision in Art. 21(2) of the WTA could not be applied as a requirement, in addition to the treaty requirements, in respect of withholding tax relief.

In a notice dated 7 February 1989, the Federal Tax Administration took the position, in respect of Art. 4(11) of the Switzerland–Germany tax treaty (1971) that (1) the contracting states may not apply their unilateral anti-avoidance provisions and jurisprudential rules without limitation in the treaty context, (2) the application of unilateral anti-avoidance provisions and jurisprudential rules are allowed in specific cases in the treaty context and (3) where the tax treaty itself includes a specific provision intended to prevent a particular form of treaty abuse, such treaty abuse cannot be prevented by unilateral anti-avoidance provisions and jurisprudential rules.[32]

This position is in line with Switzerland's observation in Para. 27.9 of the OECD Commentary on Art. 1 of the OECD Model and the author's view. One cannot derive, from the nature of the international provision and the principle of *pacta sunt servanda* in Arts. 26 and 27 of the Vienna Convention, a prohibition against Switzerland

25. Federal Tribunal, 22 November 1968, *Christian Holzäpfel GmbH*, BGE 94 I 659; See Marcel R. Jung, Swiss Branch Report, "Tax Treaties and Tax Avoidance: Application of Anti-avoidance Provisions", *Cahiers de droit fiscal international*, Vol. 95a, IFA Congress 2010 Rome (The Hague: International Fiscal Association, 2010), pp. 773-792.
26. Federal Tribunal, 1 December 1933, *Société pour l'industrie de l'aluminium*, BGE 59 I 272.
27. In 1962, Switzerland enacted domestic anti-avoidance provisions to counter the improper use of its tax treaties by foreign taxpayers interposing Swiss companies. The 1962 Anti-Abuse Decree aims to protect the interests of Switzerland's treaty partners where they are the source state and Switzerland is the residence state of the person claiming treaty relief.
28. Art. 4(1)(b) of the WHT and Art. 20(1) of the Ordinance to the Federal Withholding Tax Act.
29. *A. Holding ApS*, note 3, pp. 536-562.
30. See Maja Bauer-Balmelli, *Der Sicherungszweck der Verrechnungssteuer* (Zurich: Schulthess, 2001), p. 174; Maja Bauer-Balmelli, "Altreservenpraxis – ein rechtliches Argumentarium", *IFF Forum für Steuerrecht* (2004), pp. 201-213, at p. 204; Georg Lutz, *Abkommensmissbrauch – Massnahmen zur Bekämpfung des Missbrauchs von Doppelbesteuerungsabkommen* (Zurich: Schulthess, 2005), p. 90 et seq., at p. 98; Georg Lutz and Pascal Taddei, "Neuerungen im Bereich des Abkommensmissbrauchs", *Der Schweizer Treuhänder* (2011), pp. 208-212, at p. 210; Federal Commission of Appeal in Tax Matters, 3 March 2005, *A. Holding ApS*, SRK 2003-15, Para. 3(d)(bb); *X. GmbH*, note 7, Para. 3.3.
31. *A. Holding ApS*, note 30, Para. 3(d)(bb).
32. Federal Tax Administration, 7 February 1989, in Kurt Locher, Walter Meier, Rudolf von Siebenthal, Andreas Kolb (eds.), *Doppelbesteuerungsabkommen Schweiz-Deutschland* (Therwil: Verlag für Recht und Gesellschaft, loose-leaf), B 4.11, No 37.

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applying unilateral anti-avoidance provisions and jurisprudential rules in the treaty context. Unilateral anti-avoidance provisions and jurisprudential rules can always only be in conflict with the provisions of a particular tax treaty.[33]

In order to determine whether or not unilateral anti-avoidance provisions and jurisprudential rules are in conflict with the provisions of a particular tax treaty, the judge has to carry out a rather complex interpretation process separately for each tax treaty concluded by Switzerland. The judge has to take into account in each case, in particular, (1) whether a specific treaty provision expressly allows for the application of unilateral anti-avoidance provisions and jurisprudential rules, (2) whether one of the two contracting states has entered a corresponding observation or reservation in the OECD Commentary to Art. 1 of the OECD Model and (3) the guiding principle in Para. 9.5 of the 2003 OECD Commentary on Art. 1 of the OECD Model.

Not all treaties that Switzerland has entered into are identical. In recent years, upon the request of foreign contracting states, specific treaty provisions have more and more frequently been agreed to by Switzerland. Each tax treaty is the result of the specific negotiation position of both contracting states. As a consequence, the interpretation in regard to the different tax treaties will be different.

3.2. International interpretation

The question as to whether or not unilateral anti-avoidance provisions and jurisprudential rules conflict with a treaty provision is answered in accordance with a proper interpretation of a particular unilateral provision and a particular treaty provision, in particular, considering the text, the object, the purpose and the effect of the unilateral provision or jurisprudential rule and the text, the object and the purpose of the treaty provision.[34] The question as to whether a treaty provision prevails over a particular unilateral anti-avoidance provision or jurisprudential rule in a particular case or whether treaty override applies is answered under the national law of Switzerland, notably under constitutional law. This is a much more complex legal issue than Arts. 26 and 27 of the Vienna Convention and Para. 7 et seq. of the 2003 Commentary on Art. 1 of the OECD Model would suggest. These are questions of interpretation and priority.

A particular legal system has to decide how international law becomes part of national law. The Swiss legal system follows the theory of monism, according to which international law automatically and directly becomes part of national law as international law. Unilateral and international law are parts of one legal system, international law being an integral part thereof. The Federal Tribunal has repeatedly held that international law has to be considered as Swiss federal law. No formal transformation of international law into a federal statute is required.[35] As a consequence, unilateral anti-avoidance provisions and jurisprudential rules, as well as bilateral provisions, are integral parts of one legal system.

A particular legal system also has to decide on the rank of international law within the hierarchy of norms in its legal system. The most controversial issue regarding Swiss doctrine was the rank of international law in relation to federal constitutional and federal statutory law. According to the prevailing doctrine, *ius cogens* ranks above, and the Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR) equal, to the Federal Constitution; other norms of international law, notably tax treaties, rank below the Federal Constitution, but above federal statutes.[36] Consequently, treaty provisions rank above anti-avoidance provisions laid down in federal statutes, but below the Federal Constitution (in particular, below the principle of prohibition of abuse of rights enshrined in Art. 9 of the Federal Constitution).

Finally, a particular legal system has to decide how a conflict between unilateral and international law will be resolved. The principle of *pacta sunt servanda* in Art. 26 of the Vienna Convention stipulates that an international treaty is binding upon the parties and must be performed by them in good faith. Art. 27 then stipulates further that, subject to an exception that is not relevant here, a party may not invoke the provisions of its unilateral law as a justification for its failure to perform a treaty. However, this principle of observance of international treaties does not imply a national rule of conflict according to which treaty law would prevail over unilateral law.[37] Instead, international law leaves a particular state to decide how to fulfil its treaty obligations.[38] If a state does not fulfil its treaty obligations, it may be responsible under international law.

Art. 190 of the Federal Constitution enshrines the core principle of Swiss federal constitutional law. It relates to the principle of separation of powers and stipulates that the Federal Tribunal and other judicial authorities shall apply federal acts and international law. This constitutional rule prohibits the judicial review of federal statutes and international treaties. Consequently, norms of international law must be applied even if they conflict with the Federal Constitution. This constitutional rule also does not resolve conflicts between federal statues and international law. According to the prevailing view in the Swiss doctrine, norms of federal statutes that conflict with *ius cogens* are null and void and norms of federal statutes that conflict with other norms of international

33. Vaughan Lowe, "How Domestic Anti-Avoidance Rules Affect Double Taxation Convention", *Proceedings of a Seminar held in Toronto, Canada in 1994 during the 48th Congress of the International Fiscal Association* (The Hague: Kluwer, 1995), p. 23.
34. See Luc De Broe, *International Tax Planning and Prevention of Abuse* (Amsterdam: IBFD, 2007), p. 386.
35. Federal Tribunal, 27 October 1994, *V.*, BGE 120 Ib 360, Para. 2(c); See Luzius Wildhaber and Stephan Breitenmoser, "The Relationship between Customary International Law and Municipal Law in Western European Countries", *Zeitschrift für ausländisches öffentliches Recht und Völkerrecht* 48 (1988), pp. 163-207, at p. 196 et seq.
36. Pierre Tschannen, *Staatsrecht der Schweizerischen Eidgenossenschaft* (Berne: Staempfli, 2004), p. 166.
37. Tschannen, note 36, p. 162.
38. Ulrich Häfelin, Walter Haller and Helen Keller, *Schweizerisches Bundesstaatsrecht*, 7th ed. (Zurich: Schulthess, 2008), p. 573; Tschannen, note 36, p. 162.

law may not be applied in a particular case.[39] However, if the Federal Parliament knowingly accepted the conflict of a federal statute with a treaty obligation, the Federal Tribunal is bound to apply the federal law (*Schubert* formula).[40] However, Switzerland becomes responsible under international law if it applies a federal statute that conflicts with international law.

In the leading case decided on 15 November 1991 in the matter of *Erben X.*, the Federal Tribunal reviewed the relationship between a provision of a federal tax statute and Art. 6(2) of the ECHR.[41] The court referred to Arts. 26 and 27 of the Vienna Convention, which stipulate the principle of priority of international law. This principle would require an interpretation of national law, including Art. 114bis(3) of the old Federal Constitution of 1874 (corresponding to Art. 190 of the Federal Constitution of 1999), in conformity with international law (*völkerrechtskonforme Auslegung*). Federal statutes would have to be construed not only in conformity with the Federal Constitution, but also with international law. This interpretation method would require that a conflict be avoided as far as possible. Art. 114bis(3) of the old Federal Constitution stipulated the principle of observance, but did not contain a principle of prohibition of review. The judge may review a particular legal norm to determine whether or not it conflicts with the Federal Constitution or international law and also may invite the legislative body to amend the legal norm at issue. This international interpretation method established by the Federal Tribunal is the unilateral counterpart to Arts. 26 and 27 of the Vienna Convention.

In conclusion, the Federal Tribunal may review whether unilateral anti-avoidance provisions laid down in federal statutes are in conformity with the provisions of a tax treaty. If there is an unavoidable conflict between a unilateral anti-avoidance provision and an obligation created by a tax treaty, pursuant to an international interpretation (*völkerrechtskonforme Auslegung*) the latter, in principle, prevails. However, the principle of prohibition of abuse of rights in Art. 9 of the Federal Constitution ranks above treaty provisions (*treaty override*).

4. Abuse of Rights Doctrine

Modern Swiss legal methodology indicates that judges have the power to fill an apparent loophole in the law (*unechte Gesetzeslücke*) and to adjust a federal statute and, as a consequence, to depart from the text of a legal norm (*contra legem*). This is derived directly from the principle of prohibition of arbitrariness (*Willkürverbot*) in Art. 9 of the Federal Constitution if an obvious abuse of rights is present. It appears that this power represents an extraordinary exception to the principle of observance (*Anwendungsgebot*) in Art. 190 of the Federal Constitution.[42] Gächter argues in favour of this development of law *contra verba legis* by referring to the constitutional concept of practical concordance (*Konzept der praktischen Konkordanz*), which embraces the principles of the unity of the constitution and the equality of constitutional law.[43]

Even though the principle of prohibition of abuse of rights enshrined in Art. 2(2) of the Federal Civil Code (CC) has its origins in the *exceptio doli generalis* of Roman law, its universal application goes back to Eugen Huber, the author of the CC.[44] Under Roman law, the *exceptio doli* had a wide field of application. It was one of the most important objections. It was based on the requirement that nothing happened or is happening through *dolus malus* of the claimant. One can read the traditional expression of Gaius: *male enim nostro iure uti non debemus* – we must not exercise our right in a bad manner.[45] The defendant invoked that the judicial enforcement of the claim would present a fraudulent and unfaithful action of the claimant (*exceptio doli generalis*). The *exceptio doli* was generally used to break down the power of the formal law if its enforcement was seen as a violation of good faith. According to the Federal Tribunal's case law regarding the principle of prohibition of abuse of rights enshrined in Art. 2(2) of the CC, an abuse of rights is present if a right is inappropriately exercised to realize interests that the right does not intend to protect.[46]

5. Tax Avoidance Doctrine

5.1. Judicial tax avoidance doctrine

In its leading case of 1 December 1933 in the matter of *Société pour l'industrie de l'aluminium*, the Federal Tribunal adopted the German avoidance doctrine.[47] The court referred to Sec. 10 of the German Tax Act of 22 May 1931 that, in turn, originates from Sec. 5 of the Tax Act of 13 December 1919 (as it read in August 1925). Since then, the Federal Tribunal's case law stipulates three requirements that must be fulfilled: (1) it must be apparent that the legal form chosen by the taxpayer is unwarranted, inappropriate or unusual and, in all cases, completely inappropriate to the economic facts (*the objective element*); (2) the decision must have been made by the taxpayer solely with the intention of saving tax (*the subjective element*); and (3) the method chosen by the taxpayer would have had to effectively lead to a substantial tax saving (*the factual element*). The subjective element relates back to the commentary to Sec. 5(5) of the Tax Act of 13 December 1919 (as it read in August 1925), pursuant to which the taxpayer must have had the *intention* to avoid the tax.[48]

39. Tschannen, note 36, p. 166 et seq.
40. Federal Tribunal, 2 March 1973, *Schubert*, BGE 99 Ib 39.
41. Federal Tribunal, 15 November 1991, *Erben X.*, BGE 117 Ib 367.
42. Thomas Gächter, *Rechtsmissbrauch im öffentlichen Recht* (Zurich: Schulthess, 2005), p. 378 et seq.; Peter Locher, "Rechtsmissbrauchsüberlegungen im Recht der direkten Steuern der Schweiz", *Archiv für Schweizerisches Abgaberecht* 75 (2006/2007), p. 690; René Matteotti, *Steuergerechtigkeit und Rechtsfortbildung. Ein Rechtsvergleich zwischen der Schweiz und den Vereinigten Staaten von Amerika unter besonderer Berücksichtigung der wirtschaftlichen Betrachtungsweise* (Berne: Staempfli, 2007), p. 243 et seq.
43. Gächter, note 42, p. 369 et seq.
44. Gächter, note 42, p. 24 et seq.
45. Heinrich Honsell, *Römisches Recht*, 7th ed. (Berlin: Springer, 2010), p. 175.
46. Federal Tribunal, 28 October 1960, *Ulrich gegen Hafner*, BGE 86 II 417, Para. 2 and Federal Tribunal, 1 March 1995, *R.*, BGE 121 II 5, Para. 3(a).
47. *Société pour l'industrie de l'aluminium*, note 26, Para. 8(b).
48. Enno Becker, *Die Reichsabgabeordnung vom 13.12.1919*, 5th ed. (Berlin: Carl Heymanns, 1926), Para. 5 of Art. 5.

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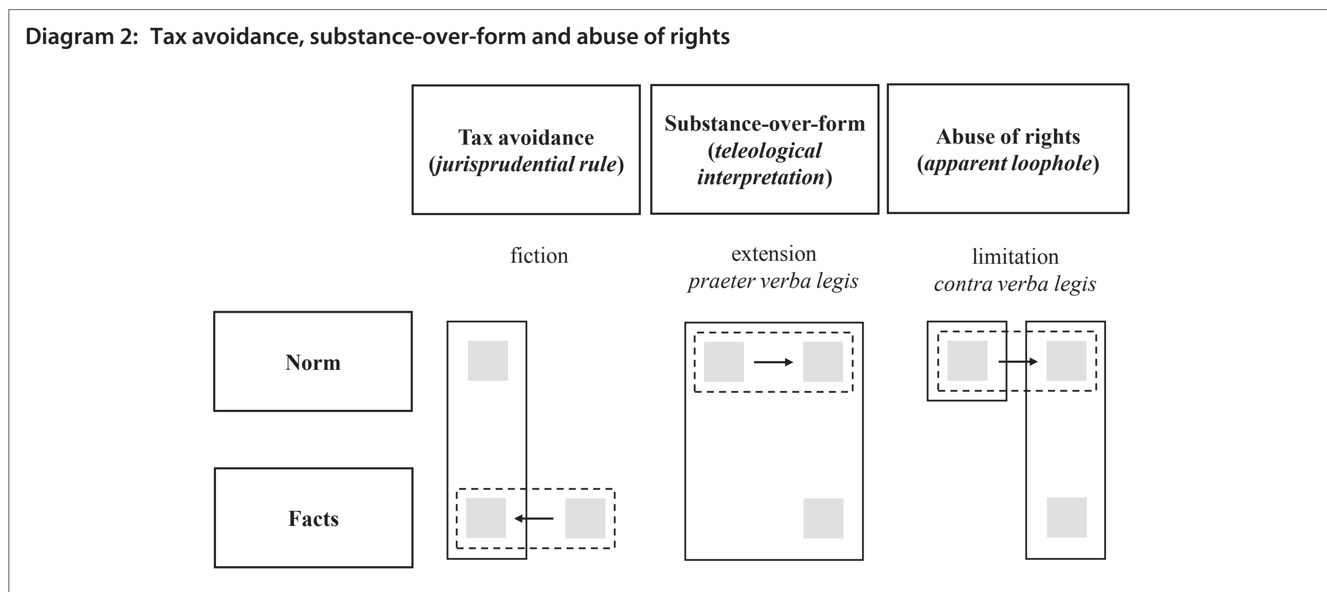
Diagram 2: Tax avoidance, substance-over-form and abuse of rights



If the requirements of the judicial tax avoidance doctrine are fulfilled, taxes are levied in the way they would have been levied had the legal arrangement in regard to the economic circumstances been proper. The judicial tax avoidance doctrine assumes a fictitious pattern of facts. In practice, it is applied under the guise of the substance-over-form approach. It does not involve, however, a substance-over-form interpretation at the level of a tax provision (level of the legal norm) or substance-over-form consideration of the realized facts (level of the facts). It is, rather, a fictitious consideration of the facts (level of the facts). The realized facts are not economically acknowledged by the tax authority, but substituted by fictitious facts. The fictitious facts fulfil the requirements of the tax provision and trigger the tax. By means of a fiction, the realized pattern of facts is drawn "under" the tax provision.

In the author's view, a different legal effect of the judicial tax avoidance doctrine, compared to the prohibition of abuse of rights enshrined in Art. 2(2) of the CC and Art. 9 of the Federal Constitution, respectively, crystallizes in respect to the attribution of income. The judicial tax avoidance doctrine attributes income to the person who would have realized the income based on the assumed (*fictitious*) facts. In contrast, the prohibition of abuse of rights prohibits the enforcement of the claim based on the realized (*real*) facts if an obvious abuse of rights is present. In this respect, the judicial tax avoidance doctrine is also a unilateral attribution rule. In respect of the attribution of income, the effect of the judicial tax avoidance doctrine may be divided into two aspects: (1) a rule regarding the *fictitious* attribution of income as part of the basic rules set by unilateral law for determining which facts give rise to tax liability and (2) a rule regarding the *fictitious* attribution of income as part of the basic rules set by unilateral law for relief from withholding tax.

5.2. Statutory anti-avoidance provision

The Federal Parliament enacted the judicial tax avoidance doctrine in Art. 21(2) of the WTA. According to this anti-avoidance provision, no refund of the federal withholding tax shall be provided in circumstances where it would result in tax avoidance.

A controversial issue in the Swiss doctrine is the question as to whether or not this statutory anti-avoidance provision is also applicable to a tax treaty or only in the domestic context. In the author's view, a constitutional interpretation (*verfassungsmässige Auslegung*) in light of the principle of equal treatment enshrined in Art. 8 of the Federal Constitution warrants its application in both the domestic and treaty context.[49] Irrespective of whether one comes to the conclusion that it is applicable in the treaty context, the general judicial tax avoidance doctrine, as established by the Federal Tribunal, would still apply.

5.3. International effect of the tax avoidance doctrine?

In the author's view, based on an international interpretation of Art. 21(2) of the WTA, it may be stated that:[50]

– Art. 21(2) of the WTA is generally applicable to tax treaties; its application is, however, restricted by international obligations created by the tax treaty, in particular, to the extent that its application is in conflict with particular treaty provisions on the attribution of income (*attribution rules*) that correspond, for example, to Arts. 10–12 of the OECD Model (for example, "paid to" and "received from"), have to be interpreted *autonomously*, and prevail over unilateral rules on the attribution of income according to the principle of *lex specialis derogat legi generali*;[51]

49. See Federal Tribunal, 25 September 2009, *Dorothee Jaun gegen Kanton Zurich*, 2C_30/2008; Federal Tribunal, 25 September 2009, *X. und Y. gegen Kanton Schaffhausen*, 2C_49/2008; Federal Tribunal, 25 September 2009, *Susanne Leutenegger Oberholzer, Irene Meier-Heid, Annette Stähli-Kurtze gegen Kanton Basel-Landschaft*, 2C_62/2008; Federal Tribunal, 25 September 2009, *Rudolf Hausherr gegen Kanton Bern*, 2C_274/2008. See Marcel R. Jung, "Individual Shareholder Relief Rules Found Incompatible with the Swiss Federal Constitution", *European Taxation* 4 (2010) pp. 168-172; Heuberger and Oesterhelt, note 13, pp. 285-294.
50. See *Erben X.*, note 41.
51. See the discussion on the concept of attribution of income in the field of relief from withholding taxes under Swiss treaty law in Beat Baumgartner, *Das Konzept des beneficial owner im internationalen Steuerrecht der Schweiz* (Zurich: Schulthess, 2010), p. 162 et seq., at p. 169.

- in the absence of a particular treaty provision expressly allowing for the application of unilateral anti-avoidance provisions and jurisprudential rules or a corresponding observation or reservation to Art. 1 of the OECD Commentary by Switzerland or the other contracting state, Art. 21(2) of the WTA is generally not applicable to a particular tax treaty to the extent that its application conflicts with treaty provisions; this means that, due to the Swiss observation in Para. 27.9 of the 2003 OECD Commentary on Art. 1 of the OECD Model, abuse must not be prevented by Art. 21(2) of the WTA according to the principle *lex specialis derogat legi generali* to the extent that its application has a more far-reaching effect than a particular treaty provision if a specific form of treaty abuse is prevented by a particular treaty provision (for example, a minimum holding period clause);[52]
- Art. 21(2) of the WTA is generally applicable to a particular tax treaty, irrespective of whether or not its application could, in principle, be restricted by international obligations created by the tax treaty, if the tax treaty provides for a particular treaty provision expressly allowing for the application of unilateral anti-avoidance provisions and jurisprudential rules or Switzerland or the other contracting state has entered a corresponding observation or reservation to Art. 1 of the OECD Commentary; this means, for example, that Art. 21(2) of the WTA is generally applicable to the Switzerland–Germany tax treaty (1971) (as it reads following the protocol of 12 March 2002, in force since 24 March 2003) based on Art. 23(1) (as it reads after the said protocol), which states that the tax treaty shall not be construed in a way that would restrict a contracting state in applying its unilateral provisions required for the prevention of avoidance or evasion;
- the guiding principle in Para. 9.5 of the 2003 OECD Commentary on Art. 1 of the OECD Model serves as an aid to interpretation; this means that the application of Art. 21(2) of the WTA is restricted in accordance with the guiding principle in Para. 9.5.[53]

Para. 9.5 of the 2003 Commentary on Art. 1 of the OECD Model has introduced a guiding principle related to the abuse of tax treaties. The benefits of a tax treaty should not be available where a main purpose (a main purpose test) for entering into an arrangement was to secure a more favourable tax position and obtaining such more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions (abuse of rights test).

In conclusion, in the absence of a particular treaty provision expressly allowing for the application of unilateral anti-avoidance provisions and jurisprudential rules or a corresponding observation or reservation to Art. 1 of the OECD Commentary by Switzerland or the other contracting state, Art. 21(2) of the WTA or the general judicial tax avoidance doctrine, respectively, are generally not applicable to a particular tax treaty to the extent that particular treaty provisions on the attribution of income, corresponding, for example, to Arts. 10–12 of the OECD Model (for example, "paid to" and "received from"), have to be interpreted autonomously, and prevail over unilateral rules on the attribution of income according to the principle of *lex specialis derogat legi generali*.

Art. 4(11) of the Switzerland–Germany tax treaty (1971) states that a person is not resident in a contracting state in respect of income and assets if they cannot be attributed to this person but are attributed to another person. Because of the text of this treaty provision one may prima facie take the view that this provision, related to beneficial ownership, would, in principle, allow the contracting states to apply unilateral attribution rules. Referring to the German doctrine, this view was taken by the Federal Administrative Court from a Swiss point of view in its decision of 30 October 2008 in the matter of *A. GmbH*.[54] This comparative reference by the Federal Administrative Court is, however, not convincing. According to the German attribution doctrine (*Zurechnungstheorie*), Sec. 42 of the Tax Act, as a unilateral attribution provision, is not affected by treaty law. In its decision of 20 March 2002 in the matter of *Hilversum I*, the Federal Finance Court held,[55] similar to the Senate's view, that one has to distinguish between the tax treaty, which constitutes international law, and the approval act (*Zustimmungsgesetz*) by virtue of which the tax treaty is transformed into national law. The national legislator would not be prevented from amending or repealing the approval act by a law that deviates therefrom provided that the legislator clearly expresses its desire for the act to have priority over treaty law and this is clearly expressed in the deviating act. This would be the case for Sec. 50d(1) of the Income Tax Act. Further, the court also stated in *Hilversum I*, equally, that Sec. 42 of the Tax Act, as a national attribution provision, is not affected by treaty law.

This attribution doctrine derived from the German law perspective and the German legislator's desired priority of Sec. 42 of the Tax Act over treaty law (treaty override) cannot be transferred to the Swiss legal system and applied by analogy to Art. 21(2) of the WTA. Due to the German dualistic constitutional system, a specific transformation system exits where an international treaty becomes part of national law by a national approval act (*Zustimmungsgesetz*). The question as to whether a tax treaty prevails over Art. 21(2) of the WTA in a specific case, or whether treaty override is present, is answered according to the monistic constitutional law of Switzerland. As noted in 3.2., the Federal Tribunal feels bound to apply any federal law that conflicts with international law if the Federal Parliament knowingly accepted the conflict between a federal statute and a treaty obligation (*Schubert* formula).[56]

52. Jung, note 25, p. 116.
53. Jung, note 25, p. 116.
54. *A. GmbH*, note 6.
55. Federal Finance Court, 20 March 2002, *Hilversum I*, I R 38/00, BStBl II 2002 819.
56. *Schubert*, note 40.

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6. Federal Administrative Practice

There is a trend in the federal administrative practice to interpret broadly the treaty requirement of beneficial ownership and to subsume different anti-abuse concepts under this requirement. The Federal Tax Administration combines pattern of facts that were acknowledged in the case law of the last 25 years in respect of different bilateral anti-avoidance provisions under the title of beneficial ownership. This development of the law resulted in the decision of 28 November 2008 in the matter *A. Holding ApS*, a decision of the highest court wherein the question of substance of a company resident in a foreign contracting state was no (longer) answered based on the criteria of the tax avoidance intention (*Steuerumgehungsabsicht*)[57] or beneficial ownership (*Nutzungsberechtigung*),[58] but based on a prohibition of abuse of rights (*Verbot des Rechtsmissbrauchs*).[59]

The treaty concept of beneficial ownership has to be clearly distinguished from the residence requirement as laid down in Art. 4(1) of the OECD Model and the tie-breaker rule in Art. 4(2) and (3) of the OECD Model. The concept of residence requires that the person who requests treaty benefits is liable to tax under the laws of the residence state by reason of his domicile, residence, place of management or any other criterion of a similar nature. This excludes persons who are liable to tax in that state only in respect of income from sources in that state or capital situated therein. The concept of residence, consequently, relates to the formal requirement of unlimited tax liability (residence taxation). A letter-box company can, therefore, also be resident in the other contracting state.

The question of substance of a company in the residence state (for example, offices, employees, etc.) has nothing to do with this. A letter-box company resident in the other contracting state may also be the legal and economic beneficial owner of dividends received from its Swiss subsidiary. The refusal to recognize beneficial ownership would have to result from a substance-over-form consideration at the level of the (realized) facts, based on particular corporate and contractual legal relationships that render the foreign letter-box company, in relation to the income received, a mere nominee or agent acting on account of the interested parties. The letter-box company, however, typically lacks the market-economy connecting factor with its residence state. According to recent case law of the Federal Tribunal, the use of a letter-box company can be challenged by the (unwritten) treaty principle of prohibition of treaty abuse.[60]

7. Federal Tribunal's Case Law

7.1. Unilateral versus bilateral concept of attribution of income

There is a trend in the Federal Tribunal's case law to apply the judicial tax avoidance doctrine in the national and non-treaty context and the principle of prohibition of abuse of rights and the (unwritten) treaty principle of prohibition of treaty abuse in the treaty context. The prohibition of abuse of rights doctrine counters the abusive use of a tax treaty relief provision that results, ultimately, in abusive avoidance of a unilateral tax law provision of Switzerland.

As already stated in 5.1., the legal consequence of the judicial tax avoidance doctrine may be that income is attributed to the person who would have realized the income based on the assumed (*fictitious*) facts. In this respect, the judicial tax avoidance doctrine is also a *unilateral* attribution rule. It seems that the Federal Tribunal does not apply the judicial tax avoidance doctrine in the field of relief from withholding taxes under Swiss treaty law. Instead, the Federal Tribunal attributes income in accordance with the treaty provisions on the attribution of income (*attribution rules*) to the person who realized the income based on the realized (*real*) facts. This case law is in line with the view taken by the author that particular treaty provisions on the attribution of income that correspond, for example, to Arts. 10–12 of the OECD Model (for example, "paid to" and "received from"), that have to be interpreted autonomously, and prevail over the unilateral judicial tax avoidance doctrine and Art. 21(2) of the WHT, respectively, according to the principle of *lex specialis derogat legi generali*.

Treaty benefits are not refused by the Federal Tribunal based on the argument that income would have to be attributed to another person based on the judicial tax avoidance doctrine, but based on the argument that the person who asks for treaty relief is *not entitled*; treaty protection *is refused* contrary to the text of the legal treaty norm (development of law *contra verba legis*). The Federal Tribunal's case law does not give the judicial tax avoidance doctrine a direct or indirect effect in the treaty context.

7.2. Non-treaty context

In its decision of 30 January 2006 in the matter of *Masse en faillite de A. S.A.* the Federal Tribunal disregarded the legal personality of the foreign company C-Inc. with its legal seat in Panama in the non-treaty context based on the judicial tax avoidance doctrine. The court attributed the offshore company's income and assets to its sister company A-AG resident in Switzerland.[61] The court, in particular, noted that there was no clear separation between the Swiss and the offshore company's assets.

7.3. Treaty context

In the *A. Holding* case, the question arose as to whether an (unwritten) treaty principle of prohibition of treaty abuse can be derived from interpreting Art. 10(1) of the Switzerland–Denmark tax treaty (1973) (as it read before the protocol of 21 August 2009, in force since 22 November 2010).[62]

57. *Y. B.V.*, see note 1, pp. 64-74.
58. *V. S.A.*, see note 2, pp. 191-214.
59. *A. Holding ApS*, see note 3, pp. 536-562.
60. *A. Holding ApS*, note 3, pp. 536-562.
61. Federal Tribunal, 30 January 2006, *Masse en faillite de A. S.A.*, 2A.145/2005.
62. *A. Holding ApS*, note 3, pp. 536-562.

In 1999, A. Holding Aps was established by C. Ltd., a company resident in Guernsey. C. Ltd., in turn, was held by D. Ltd, a company resident in Bermuda. E., who was also resident in Bermuda, was the sole shareholder of D. Ltd. In 1999, A. Holding Aps acquired all of the shares in F. AG, resident in Switzerland. In 2000, F. AG paid a dividend of CHF 5,000,000 and withheld therefrom withholding tax of CHF 1,925,000. A. Holding Aps asked for a full refund of the withholding tax pursuant to Art. 10(1) of the Switzerland–Denmark tax treaty (1973).

The court did not raise the question of whether the legal personality of A. Holding ApS, with its legal seat in Denmark, has to be disregarded for Swiss tax purposes even though A. Holding ApS was a letter-box company. The presence of a domestic or foreign letter-box company is not sufficient grounds to disregard the legal personality of a Swiss or foreign company for Swiss tax purposes.[63]

Art. 10(1) of the Switzerland–Denmark tax treaty (1973) (as it read before the protocol of 21 August 2009, in force since 22 November 2010) provided for a zero dividend withholding tax rate. According to the text of this treaty provision, Switzerland had to refund the full amount of withholding tax levied on dividend payments to dividend recipients resident in Denmark. The Federal Tax Administration, however, refused the refund of the withholding tax on grounds that A. Holding ApS was established primarily for the purpose of the improper use of the benefits of the Switzerland–Denmark tax treaty. The treaty does not expressly include the beneficial ownership requirement and stipulates neither bilateral anti-avoidance provisions nor a provision that allows for the application of unilateral anti-avoidance measures.

The Federal Tribunal referred to Arts. 26 and 31(1) of the Vienna Convention for the interpretation and application of a tax treaty. According to the Federal Tribunal's case law, account shall be taken, in interpreting a tax treaty, in addition to its text, of how the contracting parties might have understood the *purpose* of the treaty in accordance with the principle of good faith, unless the judge can derive a different contractual intention of the contracting parties from its origin. Both the context of the treaty provision and its object and purpose play a role in the interpretative process. Good faith, as well as the object and purpose, have to be taken into account for each interpretation of a treaty provision. Each contracting state might expect that the other will take into account these principles. This would also include the prevention of treaty abuse. The Federal Tribunal derived from Art. 31(1) of the Vienna Convention an (unwritten) *treaty* principle of prohibition of treaty abuse that it construed with the aid of the principle of prohibition of abuse of rights enshrined in Art. 2(2) of the CC.[64]

Due to the rank of bilateral tax treaties within the hierarchy of norms under Swiss domestic law, pursuant to which treaty provisions rank below the Federal Constitution, but above federal statutes, and the constitutional concept of practical concordance, in the author's view, the judge may derive an (unwritten) *constitutional* principle of prohibition of treaty abuse from the principle of arbitrariness enshrined in Art. 9 of the Federal Constitution that prevails over treaty law (treaty override).[65]

The Federal Tribunal prevented such treaty override by deriving the principle of prohibition of treaty abuse from Art. 31(1) of the Vienna Convention rather than from Art. 9 of the Federal Constitution. In contrast to the (unwritten) *treaty* principle of prohibition of treaty abuse that the court derived from *treaty law*, the (unwritten) *constitutional* principle of prohibition of treaty abuse does not conflict with Switzerland's observation in Para. 27.9 of the OECD Commentary on Art. 1 of the OECD Model that it does not share the view expressed in Para. 7 of the OECD Commentary on Art. 1 of the OECD Model according to which the purpose of tax treaties is to *prevent tax avoidance* and evasion.

8. Federal Administrative Court's Case Law

8.1. Fictitious attribution of income

In the *A. GmbH* case, the Federal Administrative Court gave the attribution consequences of the judicial tax avoidance doctrine an *indirect* international effect in the treaty context.[66] The issue was a transfer of a participation in a Swiss limited liability company C. GmbH by individual persons E. and F. resident in Germany to a holding company A. GmbH also resident in Germany. The share transfer was arranged in 2002. C. GmbH paid two dividends, one of CHF 307,919 in 2002 and the other of CHF 552,682 in 2004. Thereafter, the German holding company A. GmbH asked for full refund of the withholding tax and requested the benefits of the inter-company dividend treaty provision in Art. 10(3) of the Switzerland–Germany tax treaty (1971) (as it reads following the protocol of 12 March 2002, in force since 24 March 2003).

The Federal Administrative Court referred to the Federal Tribunal's decision in *A. Holding ApS* and invoked the (unwritten) treaty principle of prohibition of treaty abuse that would have been applicable to the treaty prior to the entry into force of the protocol of 23 March 2003. The court argued that the (unwritten) treaty principle of prohibition of treaty abuse would, in effect, have an identical scope of application as the judicial tax avoidance doctrine.

Both cases relate to the prevention of the fiscal abuse of rights and the filling of an apparent loophole in the tax law or in the tax treaty. The Federal Administrative Court held that tax avoidance would be present because the arrangement of A. GmbH obviously primarily served the purpose of saving taxes in Switzerland, the arrangement would effectively lead to a saving and would be entirely inappropriate to the economic realities. The court argued that there would be no reasonable arguments, other than tax reasons, for holding the custody account with Bank D. through two shell companies. Finally, the court held that

63. *X. und Y. gegen Kanton Schaffhausen*, note 49, Para. Ziff. 5.4; See René Matteotti, "Der Durchgriff bei von Inländern beherrschten Auslandsgesellschaften im Gewinnsteuerrecht der Schweiz" (Berne: Staempfli, 2003), p 192; Locher, note 42, p. 693.
64. *A. Holding ApS*, note 3, pp. 536-562, Para. 3.4.3.
65. Jung, note 25, pp. 773-792.
66. *A. GmbH*, note 6.

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there would be nothing against the lower court answering questions regarding tax avoidance by way of the case law of the Federal Tribunal, even in regard to dividends paid before 24 March 2003. In essence, it would not be relevant whether the prohibition of fiscal abuse of rights is derived from a tax treaty, the Vienna Convention or unilateral law (Art. 2(2) of the CC).

The Federal Administrative Court refused a refund of the withholding tax to A. GmbH primarily based on the lack of beneficial ownership. Secondly, the refund was refused in respect of dividends paid after 24 March 2003 based on the judicial tax avoidance doctrine and in respect of dividends paid before 24 March 2003 based on the (unwritten) treaty principle of prohibition of treaty abuse that was construed by the court with the aid of the judicial tax avoidance doctrine. The court attributed the dividends paid by C. GmbH not to A. GmbH, but, based on *fictitious* facts, to E. and F., the previous shareholders of C. GmbH. This case gives the attribution consequences of the judicial tax avoidance doctrine an *indirect* international effect in regard to treaty law.

The Federal Administrative Court modified the (unwritten) treaty principle of prohibition of treaty abuse in so far as it was construed by the court with the aid of the judicial tax avoidance doctrine. Only with the help of this modification, was it possible to attribute the dividends paid by C. GmbH not to A. GmbH but, based on *fictitious* facts, to E. and F.

In contrast to the court's findings, as stated in 4., the prohibition of abuse of rights and the judicial tax avoidance doctrine have to be clearly distinguished in terms of their *origin* and *scope*.[67] The Federal Tribunal construed, in its decision of 28 November 2005 in the matter of *A. Holding ApS*, an (unwritten) treaty principle of prohibition of treaty abuse with the aid of the prohibition of abuse of rights enshrined in Art. 2(2) of the CC rather than the judicial tax avoidance doctrine.[68] The principle of abuse of rights does not base a refusal of treaty benefits on the argument that income would have to be attributed to another person based on the judicial tax avoidance doctrine, but based on the argument that the person who asks for treaty relief is not entitled. The decision of 30 October 2008 clouds the clear line between the fictitious attribution of income based on assumed (*fictitious*) facts, on the one hand, and the refusal of an inappropriate exercise of a right to realize interests that the right is not intended to protect based on the realized (*real*) facts, on the other.

8.2. Tax avoidance intention

In a further decision of 23 March 2010 in the matter of *X. GmbH*, the Federal Tribunal confirmed its case law regarding the indirect attribution consequences of the judicial tax avoidance doctrine in the treaty context.[69] This case dealt with a transfer of a participation in an economically liquidated Swiss company C. AG by a Dutch company D. B.V. to an Austrian company X. GmbH. The share transfer was arranged in 2003. C. AG paid two dividends, both in 2002. Thereafter, the Austrian X. GmbH asked for a full refund of the withholding tax and requested the benefits of the inter-company dividend treaty provision in Art. 10(2) of the Switzerland–Austria tax treaty (1974) (as it reads following the protocol of 20 July 2000, in force since 13 September 2001).

The Federal Administrative Court stated that the tax treaty concluded between Switzerland and Austria would not include a written anti-avoidance provision such as the "arranged-or-maintained" clause in Art. 9(2)(a)(i) of the Switzerland–Netherlands tax treaty (1951) (as it read following the protocol of 22 June 1966, in force effective 22 October 1966, will be repealed by the Switzerland–Netherlands tax treaty (2010)). The court referred again to the Federal Tribunal's decision in *A. Holding ApS* and invoked the (unwritten) treaty principle of prohibition of treaty abuse that would also be applicable to the Switzerland–Austria tax treaty (1974). The court noted that an allegation of treaty abuse naturally would require a subjective element, as there would need to be an inappropriate exercise of a right to realize interests that the right does not want to protect and, therefore, wilful action. Consequently, abuse would only be present if the arrangement was chosen solely for the purpose of saving tax. If this were the case, one would have to refuse the formal facts and *assume facts* that would have been appropriate. The court argued that the appropriate facts would have been the distribution of the dividend by C. AG to the Dutch D. B.V. prior to the share transfer. In this scenario, a residual withholding tax of 15% would have applied.

The court attributed the dividends paid by C. AG not to X. GmbH, but, based on fictitious facts, to D. BV. The court denied X. GmbH the full 15% withholding tax refund based on the (unwritten) treaty principle of prohibition of treaty abuse that was construed by the court with the aid of the judicial tax avoidance doctrine.

In contrast to the court's findings and its second modification of the Federal Tribunal's (unwritten) treaty principle of prohibition of treaty abuse in this second case, in the author's view, the subjective element of intention has no relevance to the abuse of rights doctrine.[70] Intention also has no relevance to the concept of abuse in the OECD Commentary. The OECD concept of abuse in Para. 9.5 of the 2003 Commentary to Art. 1 of the OECD Model has introduced a guiding principle according to which treaty benefits shall not be granted if:

– a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position (*a main purpose-test*); and

67. See Locher, note 42, pp. 675-700.
68. *A. Holding ApS*, note 3, pp. 536-562, Para. 3.4.3.
69. *X. GmbH*, note 7.
70. In contrast to the judicial tax avoidance doctrine as proposed by Enno Becker, the abuse of rights pursuant to Art. 2(2) of the CC does not require the presence of a tax avoidance intention. See Peter Böckli, "Steuerumgehung: Qualifikation gegenläufiger Rechtsgeschäfte und normative Gegenprobe", in Ernst Höhn and Klaus Vallender (eds.), *Steuerrecht und Rechtsstaat* (Berne: Haupt, 1990), pp. 289-314, at p. 304; Jung, note 21, p. 126; Locher, note 42, p. 681. The tax avoidance intention is the typical element of the judicial tax avoidance doctrine.

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- obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions (*abuse of rights-test*).

The prohibition of abuse of rights prohibits the inappropriate exercise of a right to realize interests that the right does not protect. The (unwritten) treaty principle of prohibition of treaty abuse relates, therefore, to the *purpose* of an arrangement.

The Federal Administrative Court used the German unofficial translation of Art. 9(2)(a)(i) of the Switzerland–Netherlands tax treaty (1951) (as it read after the amendment of 22 June 1966, in force since 22 October 1966, which will be repealed by the Switzerland–Netherlands tax treaty (2010)), rather than the original language. The German translation of the tax treaty, as published in the Federal Register, uses the term "*in erster Linie in der Absicht*" (primarily with the intention) in Art. 9(2)(a)(i). Both the French and Dutch languages had equal authenticity. The French version states, "*la relation entre les deux sociétés n'ait pas été établie ou ne soit pas maintenue principalement afin de bénéficier de ce remboursement total*". Taking into account Para. 17 of the 1977 OECD Commentary to Art. 10 of the OECD Model (corresponding to Para. 17 of the 2010 Commentary to Art. 10 of the OECD Model) and the guiding principle in Para. 9.5 of the 2003 Commentary on Art. 1 of the OECD Model, in the author's view, the expression "*principalement afin de*" has to be understood as "*primarily with the purpose of*" rather than "*primarily with the intention of*".[71]

9. Conclusions

The development of law by the Federal Tribunal is based on the principle of interpretation that a treaty term shall take into account, in addition to the text, what the contracting parties might understand the *purpose* of the treaty to be in accordance with the principle of good faith. In its decision of 28 November 2005, in the matter *A. Holding ApS*, the Federal Tribunal referred to an (unwritten) treaty principle that prohibits treaty abuse, which can be derived from Art. 31(1) of the Vienna Convention. Treaty benefits are not refused on the basis of the argument that Swiss-source income would have to be *fictitiously* attributed to another person based on the judicial tax avoidance doctrine, but on the argument that the person to whom Swiss-source income has to be attributed pursuant to the bilateral attribution rules provided for in the applicable tax treaty is *not entitled*. Consequently, treaty protection is refused *contrary to the text* of the legal treaty norm (development of law *contra verba legis*).

71. Art. VI(2) of the Switzerland–United States tax treaty (1951) (repealed on 19 December 1997) granted a reduced residual withholding tax of 5% for inter-company dividends provided that: "Such reduction of the rate to five percent shall not apply if the relationship of the two corporations has been arranged or is maintained primarily with the intention of securing such reduced rate." Both the English and German languages had equal authenticity. In contrast to Para. 17 of Art. 10 of the 1977 OECD Commentary this "arranged-or-maintained" clause related to the tax avoidance intention rather than the purpose of the arrangement.

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