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B: Improper use of tax treaties and source taxation: policy, practice and beyond

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Summary and conclusions

Switzerland as a source state levies withholding taxes mainly on profits distributions and interests paid on bonds and banking deposits. There is no general withholding on other interest payments, nor on other payments such as royalties.

The main focus of Swiss anti-abuse practices thus lies on dividend withholding taxation and, to a lesser extent, bond interest withholding taxation.

The Swiss tax authorities have developed a wide anti-abuse arsenal to prevent improper use of tax treaties.

In general, the Federal Tax Administration (FTA) considers an arrangement as abusive for tax treaty purposes if:

- the tested party disposes of insufficient substance;
- there is an improvement in the treaty position;
- there is an abusive intent.

The key element in this analysis is the presence of substance (which is divided between equity, functional, and infrastructural substance). The required elements of substance needed to determine the legitimacy of a structure or arrangement may vary depending on the facts and circumstances of the specific case.

Apart from this, there are a number of specific anti-avoidance practices developed by the FTA based on recurring factual patterns, thin capitalization, minimum or maximum interest rules, practices dealing with surplus stripping cases and similar situations.

According to the jurisprudence of the Swiss Federal Supreme Court (FSC), as recently clarified in a decision of 3 October 2024, the prohibition of treaty abuse is a general principle of international law, which from a Swiss perspective is applicable even in the absence of specific provisions.

According to the FSC case law, treaty benefits may only be denied if, cumulatively, both the conditions under the domestic tax avoidance rules and the conditions of treaty abuse (either based on international law or, arguably, based on a specific treaty provision such as the PPT) occur. This dual requirement arguably ensures that the denial of benefits is in line with both domestic law and international treaty obligations.

According to the longstanding practice of the FSC, from a domestic perspective tax avoidance occurs if:

- the chosen legal arrangement appears unusual, inappropriate, or peculiar, and is completely unreasonable given the economic circumstances (objective element);

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- It must be assumed that the chosen legal arrangement was abusively made solely to save taxes that would be owed under proper circumstances (subjective element);
- the chosen approach would actually lead to significant tax savings if accepted by the tax authority (effective element).

Switzerland has been actively participating in the BEPS project and has signed and ratified the MLI. It has implemented the principal purpose test (PPT) with a number of countries and is in the process of revising further double tax treaties with a view of introducing the PPT.

The main question that arises from this development is whether there will be a change in the Swiss approach towards treaty abuse. In light of the recent jurisprudence of the FTA, this does not seem to be the case. The Swiss domestic general anti-avoidance rule is less strict, as regards the subjective element, as it requires the tax savings to be the main goal of an arrangement for it to be considered abusive, whereas under the PPT it is sufficient if one of the main purposes of an arrangement is to obtain treaty benefits. Since under the recent jurisprudence of the FSC both treaty-based and domestic anti-abuse rules must be cumulatively fulfilled to deny benefits, the result would arguably be to maintain the existing domestic standard.

Part I

1. The line between proper and improper use of tax treaties

As regards source taxation, the main concerned tax in Switzerland is the federal withholding tax ("WHT",[2] see section 2 below).

In order to benefit from tax treaties, according to the practice of the Swiss tax authorities the following elements must be assessed:[3]

a) the item of income must be attributable to the person claiming treaty benefits;
b) the person requesting the treaty benefit must be a resident of the contracting State pursuant to the applicable treaty;
c) the recipient of the item of income must be its beneficial owner (see section 4.3 below);
d) the request for treaty benefits must not constitute a case of treaty abuse.

Generally speaking, WHT is collected and treaty benefits must be requested by way of reimbursement. For dividends from qualifying participations, a partial or total (depending on the treaty) exemption at source can be obtained via a special notification procedure which is subject to previous authorization by the FTA.[4]

2 Swiss Federal Act of 13 October 1965 on the withholding tax (Bundesgesetz vom 13 Oktober 1965 über die Verrechnungssteuer, Verrechnungssteuergesetz, VStG, "WHT act"), SR [number in the Swiss systematic legislation] 642.21.

3 See Oesterhelt in Oesterhelt/Stocker, *Internationales Steuerrecht der Schweiz* ("IStR"), § 24 N 5-6; Oesterhelt/Oppliger, *Rückerstattung der Verrechnungssteuer* ("Oesterhelt/Oppliger"), § 1 N 5-29.

4 See Oesterhelt/Oppliger, § 1 N 26-28 and § 12 N 1-18.

1.1. The decisive factors or elements

Apart from specific situations, for which the FTA has developed a number of specific anti-abuse practices (see section 2.1. below), the general anti-abuse practice of the Swiss tax authority is described hereinafter. It should be underscored that the FTA generally adopts uniform anti-abuse factors and standards when analyzing international cases, irrespective of the specific treaty applicable to the situation.[5]
The relevant elements or indicia for treaty abuse are generally as follows:[6]
a) the structuring seems inadequate/unusual, which generally equates to the recipient of the item of income having insufficient substance;
b) there is an improvement in the treaty position (e.g. a lower residual WHT rate);
c) there is an abusive intent.

It should be noted that the practice described here has been developed mainly for dividend payments, but should also be applicable to other treaty benefit situations.

Of the three treaty abuse elements just described, the improvement in treaty position is generally self-evident and does not require particular comments. It is sufficient that a structure allows the recipient of an item of income to benefit from a lower residual tax rate.

As regards the element of unusual structuring, the FTA generally deems a structure unusual for purposes of treaty abuse if the person claiming treaty benefits does not have sufficient substance. The FTA distinguishes three types of substance:[7]
- equity substance requires an equity ratio (based on the standalone accounts of the tested party and taking into account the book values, i.e. without considering any hidden reserves);
- functional substance is generally applicable to holding companies. It is considered fulfilled if the party requesting treaty benefits, in addition to the Swiss company making the payment subject to WHT, holds at least an additional participation in a third country with a value comparable to the Swiss entity, i.e. if the tested party exercises an international holding function;[8]
- infrastructural substance is considered to be present if the party claiming treaty benefits employs its own personnel and disposes of its own (rented or owned) remises in the State of residence. Infrastructural substance present in other group companies within the same State of residence can generally be considered towards the substance of the party claiming treaty benefits.[9]

As regards the subjective element, the FTA generally presumes the abusive intent from the fulfillment of the other two elements (i.e. insufficient substance and improvement in treaty benefits). However, as also shown in the case of the old reserves practice (see section 2.1.3. below), there may be situations, particularly in case of minority shareholders that may not impose any payments, that could be considered as lacking an abusive intent.[10]

5 Oesterhelt, IStR, § 24 N 15-17.
6 See Oesterhelt, IStR, § 24 N 18; Oesterhelt/Oppliger, § 6 N 23-24; Lutz, Abkommensmissbrauch ("Lutz"), 210-211.
7 *See* generally Oesterhelt, IStR, § 24; Oesterhelt/Oppliger, § 6; Lutz, 210-214.
8 Oesterhelt, IStR, § 24 N 22; Oesterhelt/Oppliger, § 6 N 28.
9 Oesterhelt/Oppliger, § 6 N 209-213.
10 Oesterhelt, IStR, § 24 N 37; Oesterhelt/Oppliger, § 6 N 28.

1.2. Establishment of the elements of abuse

The decisive question in the application of the FTA's anti-abuse practice is whether the various types of substance mentioned above (section 1.1) must be fulfilled alternatively or cumulatively.

The substance requirements vary depending on the circumstances of the specific case.

In general, in case of group structures of operating groups and of listed companies, if the tested party fulfils one of the three substance criteria alternatively, this is considered sufficient, as long as no intermediate holdings in non-treaty jurisdictions are present in the chain.[11]

For personal holding companies, the substance required depends on whether the ultimate beneficial owner resides in a State with which Switzerland has agreed on an equivalent residual rate for qualifying participations (e.g. 0%).[12] If that is the case (e.g. if the ultimate beneficial owner is resident in the same State as the tested party), the substance criteria can be met alternatively. If the DTA with the State of residence of the ultimate beneficial owner does not provide for an equivalent relief, or if the individual is resident in a non-treaty jurisdiction (or is not counted as a resident under the treaty in application of specific requirements that account for preferential tax regimes), the substance requirements are higher (i.e. infrastructural or functional substance are required in addition to equity substance).[13]

Higher substance requirements apply also for acquisition vehicles of funds (e.g. private equity funds). In these cases, equity substance alone is not considered sufficient and must be complemented by functional or infrastructural substance.[14]

As discussed below, treaty abuse situations may also occur to avoid real estate capital gains taxation in Switzerland, i.e. by interposing a holding company in a treaty jurisdiction that does not assign capital gains from indirect real estate transfers to the situs State. The situation in this case is not very clear, as the criteria for treaty abuse would be applied by the Cantonal tax authorities. Nevertheless, on the basis of the case discussed in section 3.2 below, it can be assumed that high substance requirements would be imposed and that the tested company would need to dispose of infrastructural substance.[15]

1.3. Guidance from the tax authorities on the line of abuse

There is little official guidance provided on the treaty abuse practice in the context of WHT, as it is developed on a case-by-case basis by the FTA.

1.4. Difference in the evaluation of proper/improper use

As mentioned below in section 2.5, from a Swiss perspective there should be no difference in whether the evaluation of a proper/improper use of a tax treaty is based on the interpretation

[11] Oesterhelt, IStR, § 24 N 30-34; Oesterhelt/Oppliger, § 6 N 39-55 and 111-149; Lutz, 210-211.
[12] Oesterhelt, IStR, § 24 N 37-41a; Oesterhelt/Oppliger, § 6 N 64-75.
[13] Oesterhelt, IStR, § 24 N 42-49; Oesterhelt/Oppliger, § 6 N 76-110.
[14] Oesterhelt, IStR, § 24 N 59-62; Oesterhelt/Oppliger, § 6 N 150-231.
[15] Oesterhelt/Opel, IStR, § 22 N 36-38.

of its distributive rules or of its SAARs or GAARs. The criteria for abuse should generally be applied uniformly, pursuant to the practice of the FTA.

1.5. Burden of proof

Generally speaking, in tax law it is the tax authority that has the burden to prove facts that increase a taxpayer's tax burden. However, the taxpayers have an extensive duty to cooperate and the tax authority (and the courts) may interpret an insufficient cooperation to the disadvantage of the taxpayer. Moreover, the tax authority only has to provide sufficient indicia for an abusive situation.[16]

1.6. Time for evaluation

Generally speaking, the presence of substance is evaluated at the time of the payment of the element of income.[17] However, the subsequence actions and circumstances may be relevant to determine whether the conditions were fulfilled in a durable manner or whether they were created artificially (e.g. creation of infrastructural substance solely for the receipt of a dividend with subsequent dismantlement immediately thereafter).

1.7. The effect if there is an improper use of the tax treaty

According to the general practice of the FTA, in case of a treaty abuse the transaction is re-characterized and analyzed disregarding the abusive structuring.[18] However, the case law of the FSC and FAT is not consistent on this points and there have been numerous occasions in which treaty benefits were simply denied without any recharacterization, even if the situation disregarding the abusive transaction would have permitted a partial reimbursement based on the applicable DTA.[19]

Outside of situations covered by the EU parent-subsidiary directive to Swiss-EU cases ((the "EU-Swiss AEoI Agreement"),[20] however (see section 2.1.3 below), the mentioned case law does not seem to have yet significantly impacted the practice of the FTA. A judicial clarification on this topic can be expected in the future.

16 See FSC decisions 9C_635/2023 of 3 October 2024, recital 16.4.3; 2C_359/2022 of 13 September 2022, recital 6.3, 146 II 6 of 31 January 2020 recital 4.2.

17 Oesterhelt, IStR, § 24 N 54-58; Oesterhelt/Oppliger, § 6 N 31 and 171-178.

18 Oesterhelt, IStR, § 24 N 19; Oesterhelt/Oppliger, § 6 N 24.

19 FSC decision 2C_359/2022 of 13 September 2022, recital 7; FSC decision 2C_69/2009 of 13 July 2009, recital 3.3. *See* also Hongler/Gmür, *Rechtsfolgen der Steuerumgehung*, StR 10/2024, 697 et seq., 701-702 (arguing that complete denial of benefits has become almost standard practice in FSC case law).

20 Agreement between the European Union and the Swiss Confederation on the automatic exchange of financial account information to improve international tax compliance, SR 0.641.926.81.

2. General information about Switzerland

Source taxation in Switzerland is mainly ensured by the WHT. This tax targets various forms of income derived from Swiss-sourced movable capital assets.

The Swiss federal withholding tax on capital income serves two main purposes: the securing purpose, as primary goal, and the fiscal purpose, as secondary goal. The withholding tax system requires payers of income (such as companies paying dividends or interest) to withhold tax before distributing the income to recipients. For Swiss residents, the tax withheld can subsequently be reimbursed or credited against their final income tax liability, provided they correctly declare the income.[21] For distributions to Swiss parent companies[22] and parent companies resident in a DTA country or in the EU[23] holding qualified participations, Swiss companies can request permission to use the so-called notification procedure granting WHT relief at source.

In accordance with its nature and goals, WHT legislation and practice strictly distinguish between its two main phases: collection and reimbursement.[24]

The interaction between the taxation at source and the possibility to obtain a reimbursement of the withholding tax upon correct declaration is designed to ensure the securing purpose of the withholding tax. If a Swiss-resident taxpayer fails to declare income properly, the tax withheld becomes a final tax, effectively penalizing non-compliance. Similarly, from a purely domestic perspective (and except where a DTA provides otherwise), foreign residents do not have a right to recover the withholding tax. Therefore, for tax evaders and non-residents the Swiss federal withholding tax generates revenue and thus serves a fiscal purpose. In this sense, as regards non-residents, the withholding tax also constitutes a useful bargaining chip in the context of the negotiation of DTAs.[25]

According to article 4 WHT act, the tax is imposed on income derived from the following types of movable capital assets:

a) bonds, debentures, and other similar debt instruments issued by Swiss residents;
b) shares and participation certificates issued by Swiss companies and cooperatives;
c) Swiss collective investment schemes;
d) bank and savings deposits with Swiss banks.

It should be underscored that, whereas all profit shares (i.e. dividends and the like) paid by Swiss resident companies is subject to WHT, interest payments are generally exempt from taxation at source except if they qualify as “bonds” or bank deposits in the sense of the WHT Act.

Also, for WHT purposes, the concept of income from shares is not limited to formally declared dividends but includes any monetary benefit granted to holders of participation

21 Bauer-Balmelli / Küpfer, *in Zweifel/Beusch/Bauer-Balmelli, Kommentar zum Schweizerischen Steuerrecht, Bundesgesetz über die Verrechnungssteuer (“VStGK”)* Vorbemerkungen VStG N 64-71; FSC decision 147 II 338 of 29 July 2021, recital 2.3, with further references.

22 Art. 20 (2) WHT act; art. 26a of the Ordinance on the WHT act of 19 December 1966 (Verordnung über die Verrechnungssteuer, Verrechnungssteuerverordnung, VStV, “WHT Ordinance”), SR 642.211.

23 Ordinance on the tax relief for Swiss dividends from significant participations held by foreign entities of 22 December 2004, SR 672.203.

24 Bauer-Balmelli / Küpfer, VSTGK, Vorbemerkungen VStG N 45.

25 Dispatch of the Federal council to Parliament concerning the WHT Act, AB [official bulletin, Amtliches Bulletin] 1963 II 953, 954.

rights or to other related parties that does not constitute a repayment of nominal capital or capital contributions.

Finally, an important characteristic of WHT that is relevant also for the purposes of abuse situations is its tax attribution principle, which differs from the one applicable for direct taxation. For purposes of WHT, the recipient of a (hidden or open) profit distribution is considered as the direct beneficiary of the distribution.[26] In other words, whereas for direct taxes it is necessary to follow the shareholding structure to determine a "reconstructed" flow of the distribution (so-called "triangular principle"), for WHT purposes distributions can be attributed to entities or persons that are not shareholders. For example, if A holds 100% of B and C and B grants a hidden profits distribution to its sister company C, then for direct tax purposes A would be considered to have received a dividend from B and made a contribution in C, whereas for WHT it is C that has directly received a profit distribution from B and thus C should generally reclaim WHT reimbursement.

2.1. The main specific anti-avoidance rules (SAARs) designed to protect source taxation

In Swiss legislation related to the WHT there are very few codified specific anti-avoidance rules. Nevertheless, there is a rich body of administrative guidance of the FTA as well as federal case law that have shaped typified cases of abusive situations and rules to deal with them, that can therefore be considered as specific anti-avoidance rules.[27]
Hereinafter, we will discuss the most relevant practices, i.e.:

- Thin capitalization rules (section 2.1.1.);
- Interest limitations (section 2.1.2.);
- The old reserves practice (section 2.1.3.);
- Liquidation by proxy (section 2.1.4.);
- International transposition and extended international transposition (section 2.1.5.).

2.1.1. Thin capitalization rules

In Switzerland, basic principles of thin capitalization rules are set forth in the legislation concerning direct taxes, specifically in articles 65 of the Federal act on the federal direct tax ("FAFDT")[28] and 29a of the Federal act on the harmonization of direct taxes of Cantons and Municipalities ("FAHDT").[29] According to the mentioned articles, interest paid on the portion of debt that economically must be considered as equity is not deductible and must therefore be added to the taxable profit. Although there is no specific legal basis for thin capitalization rules as regards the WHT, it is undisputed that interest paid on hidden equity is subject to WHT.[30]

[26] *See* Oesterhelt/Oppliger, § 2 N 149-152.

[27] *See* also Piller, Interest Limitation Rules (BEPS Action 4 / ATAD), June 2021, s. 4.2.

[28] Federal act on the federal direct tax of 14 December 1990, SR 642.11.

[29] Federal act on the harmonization of direct taxes of Cantons and Municipalities of 14 December 1990, SR 642.14.

[30] FTA, Circular letter 6a of 10 October 2024, s. 3.2; Helbing / Duss / Dubach, VSTGK, art. 4 N 141a; Oesterhelt, Zinsen auf verdecktem Eigenkapital, EF 12/2018, 1005 et seq.

Official guidance issued by the FTA has detailed what portion of debt should be considered as equity (so-called "hidden equity").[31] The FTA guidance sets forth maximum permissible loan-to-value ratios for different categories of assets. If the liabilities exceed the permissible equity, the excess is considered hidden equity insofar as the debts are directly or indirectly owed to related parties. However, even debt provided by independent third parties can be reclassified as hidden equity if it is guaranteed or otherwise secured by shareholders or related persons. As mentioned, the interest paid on hidden equity is treated as a taxable monetary benefit.[32]

The mentioned guideline acts as a "safe haven rule", meaning the taxpayer can still prove that higher debt levels are in line with the arm's length principle.[33]

2.1.2. *Interest rate limitations*

The Swiss interest limitation rules are designed to regulate the permissible interest rates on loans between shareholders or other related parties and Swiss resident companies, ensuring that these transactions are conducted at arm's length and preventing tax avoidance through excessive or insufficient interest rates.

The FTA issues annual circular letters that specify the maximum allowable interest rates for loans from related parties as well as minimum interest rates for loans granted to related parties. The FTA generally issues two annual circular letters, one for interest rates for loans denominated in Swiss francs, and one for various foreign currencies.[34]

These rates are categorized based on the type of loan and the amount involved.

The mentioned circular letters also establish minimum interest rates for loans granted by companies to related parties. The applicable interest rates depend on whether the loans are financed with equity (and no interest-bearing liabilities exist)[35] or with debt from third parties.

Loans that are reclassified as hidden equity due to excessive leverage or guarantees by shareholders cannot accrue deductible interest and are not counted when considering the maximum amount of interest permissible under the respective circular letter.[36]

The above-mentioned rules act as "safe haven". Interest rates that exceed (for liabilities towards related parties) or fall short (for receivables towards related parties) of the published rates are presumed to constitute monetary benefits that are taxable for the purposes of WHT.[37] However, the taxpayer may provide proof that a higher or lower interest rate is compliant with the arm's length principle.[38]

31 FTA, Circular letters 6 of 6 June 1997 and 6a of 10 October 2024.

32 FTA, *ibid*; Helbing / Duss / Dubach, VSTGK, art. 4 N 141a; Oesterhelt, Zinsen auf verdecktem Eigenkapital, EF 12/2018, 1005 et seq.

33 *Id*.

34 *See* e.g. for 2024 FTA, Circular letters 207 and 208 of 29 and 30 January 2024 for advance payments and loans in Swiss francs and foreign currencies, respectively.

35 This requirement has been criticized in the literature, *see* Oesterhelt, Zinssätze auf Aktionärsdarlehen, EF 3/2018, 185 et seq., 188.

36 Circular letter 207 of 29 January 2024, fn. 2.

37 *See* also FSC decision 140 II 88 of 26 November 2013, recital 5.1.

38 Circular letter 207 of 29 January 2024, s. 1 et seq.; Oesterhelt, Zinssätze auf Aktionärsdarlehen, EF 3/2018, 185 et seq., fn. 4; Helbing / Duss / Dubach, VSTGK, art. 4 N 141.

2.1.3. *Old reserves*

The practice of old reserves is applicable in situations where the residual WHT burden is reduced following a corporate restructuring or a third-party sale.

The FTA will generally consider the reduction of residual WHT burden as abusive and deny a reimbursement or reduction at source in connection with so-called "old reserves", i.e. with reference to non-operational assets that may freely be distributed by the company in question.[39]

Specifically, all assets that are not considered to be necessary for the operation of the company's business will be considered as "tainted", insofar as they may be distributed as dividends according to applicable corporate law. This means that the old reserves practice applies to the highest between non-operational assets and distributable reserves.[40]

It should be noted that the reproach of abusiveness in the old reserves practice does not target the sale or corporate restructuring as such, but rather the failure to distribute the "old reserves" prior to the sale or restructuring. [41] As such, business or non-tax considerations can rarely create an exception to the mentioned practice.[42]

Generally, if the old reserves practice is found to be applicable in a case, the FTA will deny the new reduced residual WHT (or the 0% rate) and apply the residual WHT applicable before the sale or corporate restructuring.[43] However, in the context of the international agreement that extends the EU-SWISS AEoI Agreement the FSC, relying on case law of the European Court of Justice ("ECJ"), held that there could be no partial denial of treaty benefits and thus the request for WHT refund had to be denied entirely in case of treaty abuse.[44] Swiss legal scholars have criticized this decision, arguing that the FSC has misinterpreted the ECJ case law[45] and that the EU-Swiss AEoI Agreement only contains a reference to internal anti-abuse rules and thus cannot lead to a different result than under the domestic rule.[46]

Furthermore, it should be mentioned that even outside the scope of the EU-Swiss AEoI Agreement there have been instances in which Swiss courts have confirmed a complete refusal of WHT reimbursement even if the situation before the abusive transaction would have permitted a partial reimbursement based on the applicable DTA (see section 1.7 above).

The practice is applied, in both domestic and international situations, when a sale or a corporate restructuring results in a reduction of the residual WHT burden. The legal basis for the old reserves practice is the general anti-avoidance rule contained in article 21 (2) of the WHT Act for domestic cases (i.e. cases in which the shares of the entity with old reserves

[39] Oesterhelt, IStR, § 25 N 6; Oesterhelt/Oppliger, § 7 N 258; Oberson, Précis de droit fiscal intérnational, N 875-879.

[40] Oesterhelt, IStR, § 25 N 49-50; Oesterhelt/Oppliger, § 7 N 31-32.

[41] Oesterhelt, IStR, § 25 N 6; Oesterhelt/Oppliger, § 7 N 258; *see* also FSC decision 147 II 338 of 29 July 2021, recital 5.2.

[42] Oesterhelt, IStR, § 25 N 6; *see* also FSC decision 147 II 338 of 29 July 2021, recital 5.2.

[43] Oesterhelt, IStR, § 25 N 82-83; Oesterhelt/Oppliger, § 7 N 258.

[44] FSC decision 2C_354/2018 of 20 April 2020, recital 4.5.4 with specific reference to ECJ decisions of 26 February, no. C-116/16 und C-117/16, T Danmark and Y Denmark Aps, ECLI:EU:C:2019:135, recital 90.

[45] Danon/Malek, Influence of EU case law on the prohibition of international tax abuse in Swiss practice, ASA 8/89, 477 et seq., 506-507.

[46] Oesterhelt, Altreservenpraxis vor Bundesgericht, StR 12/2020, 902 et seq., 912-914.

are transferred to a Swiss entity) and the general, implicit anti-abuse rule contained in any DTA according to the practice of the FSA (see section 2.5 below).[47]

According to the FSC, the old reserves practice can create a presumption of abuse but does not create an objective anti-abuse rule: even in old reserve cases the tax authority still needs to show that the general conditions for tax avoidance are fulfilled.[48]

The FTA applies the first-in-first-out principle, meaning old reserves are considered to be distributed first when dividends are paid out.

Old reserves do not "heal" over time; the WHT implications remain until the reserves are distributed.[49]

Examples of transactions to which the old reserves practice has been found to apply and that have been sanctioned by Swiss courts are discussed in section 2.2 below.

Nevertheless, and in accordance with the concept of tax avoidance that is immanent to the old reserves practice, there are situations which, in the practice of the FTA, are not considered as falling under the old reserves practice, e.g. transfers made by minority shareholders (with exceptions).

2.1.4. Liquidation by proxy

The practice of "liquidation by proxy" is similar to the old reserves practice as it is triggered when a sale of a Swiss company (WHT taxpayer) with shareholders that are not entitled to full recovery of WHT is sold to a third party or is the object of a corporate restructuring that leads to a reduced residual WHT rate, irrespective of whether as a result of the WHT act or of a DTA. What distinguishes the liquidation by proxy from the old reserves practice is that a subsequent liquidation of the Swiss company must take place, which is considered abusive if it is established that the liquidation was intended at the time of transfer or restructuring, which may be assumed based on relevant facts and circumstances.[50]

In cases of liquidation by proxy, the abusiveness is motivated by the fact that the economic substance of the transaction is an asset deal and that a share deal is used mainly for the purpose of reducing the WHT burden.[51]

As in the case of the old reserves practice, the consequence in case of a (partial or total) liquidation by proxy is that the benefit resulting from the transfer or restructuring is ignored and access to a lower rate of residual WHT is denied. However, the WHT consequences affect not only the open and distributable non-operational assets, but all open and hidden reserves, including potential goodwill.[52]

47 Oesterhelt, IStR, § 25 N 3-4; Oesterhelt/Oppliger, § 7 N 3-4; *see* also Lutz, 161-165.

48 FSC decision 147 II 338 of 29 July 2021, recital 3.5; *see* also FAT decision A-2744/2008 of 23 March 2010, recital 3.10.

49 Oesterhelt, IStR, § 25 N 93-94; Oesterhelt/Oppliger, § 7 N 61; confirmed in FSC decision 147 II 338 of 29 July 2021, recital 5.4.

50 Oesterhelt, IStR, § 25 N 100-104; Oesterhelt/Oppliger, § 8 N 1-10; *see* also FSC decision 2C_470/2018 of 5 October 2018, recital 6.3; FSC decision 2C_551/2009 of 13 April 2010, recital 3.3.

51 Oesterhelt, IStR, § 25 N 105; Oesterhelt/Oppliger, § 8 N 4; *see* also FAT decision A-4347/2019 of 10 March 2022, recital 5.1.5.

52 Oesterhelt, IStR, § 25 N 103; Oesterhelt/Oppliger, § 8 N 5-6; *see* also FAT decision A-4347/2019 of 10 March 2022, recital 5.1.5.

2.1.5. *International transposition and extended international transposition*

The basic concept of the international transposition is that it can be possible to convert (or transpose, hence the name) potential dividend distributions (subject to WHT) into payment streams that are not subject to WHT such as capital contribution reserves or receivables.

For example, a company resident in a non-treaty State sells a Swiss subsidiary to another Swiss subsidiary at market value, with the purchase price either being paid or left outstanding as a loan: the market value represents the totality of open and hidden reserves (including goodwill) that would be subject to WHT upon liquidation or in case of distribution, whereas the payment of a purchase price by the purchasing Swiss entity is not subject to WHT.[53]

The "classic" international transposition doctrine only applies to intra-group transactions and only if the resulting improvement of the WHT reimbursement situation is based on domestic legislation, i.e. when the purchasing or receiving entity is a Swiss company. By contrast, the international transposition is not applied in case of transfer to an entity in a DTA jurisdiction (but the transfer may trigger the old reserves practice or the liquidation by proxy practice).[54]

The consequence of an international transposition case is that the FTA denies the additional WHT relief resulting from the transfer when dividends are distributed from the transferred entity to the transferee.[55]

The so-called "extended" international transposition is a relatively new (unpublished) practice of the FTA[56] which essentially targets two situations:[57]

a) a third-party purchaser that is not entitled to a full reimbursement of WHT (e.g. a private-equity fund) acquires a Swiss target company via a newly established Swiss acquisition company that is funded with loans and capital contribution reserves that may subsequently be reimbursed WHT-free to the foreign purchaser.
b) prior to a sale to a third party purchaser that does not benefit from a 0% residual WHT rate the seller (entitled to full WHT refund) restructures the target in a way to create substantial capital contributions reserves (i.e. by means that – if the seller were not entitled to a full WHT refund – would constitute an international transposition, such as the contribution of the target company into a new Swiss sub-holding). The purchaser thus purchases a target with substantial capital contribution reserves that can be reimbursed free of WHT.

2.2. Effectiveness, frequency, and litigation

Most of the cases that are targeted by the anti-avoidance practices of the FTA concern international transactions and restructurings involving Swiss companies. In these situations, it is standard practice to obtain tax rulings in advance of the transaction. As the FTA has

[53] *See* also OESTERHELT, IStR, § 26 N 6-11; OESTERHELT/OPPLIGER, § 9 N 5-8.

[54] OESTERHELT, IStR, § 26 N 22-24; OESTERHELT/OPPLIGER, § 9 N 9-12.

[55] OESTERHELT, IStR, § 26 N 8; OESTERHELT/OPPLIGER, § 9 N 4.

[56] It was presented for the first time by a member of the FTA at a seminar in 2019, *see* OESTERHELT, *Erweiterte internationale Transponierung*, FStrR 2020, 40 et seq., footnote 4.

[57] OESTERHELT, IStR, § 26 N 26-27; OESTERHELT/OPPLIGER, §10 N 1-4; SUTTER/AEBI, *Steuerumgehung bei der erweiterten internationalen Transponierung*, FStrR 2022, 457 et seq., 458-459.

discretion on whether to grant a tax ruling or not and its decision is not subject to judicial scrutiny,[58] it is rare that taxpayers would still execute a restructuring or another transaction without a tax ruling and thus risking having to litigate their tax position with respect to WHT reimbursement.

It is therefore not surprising that the body of case law concerning the anti-abusive practices of the FTA is not very extensive.

Hereinafter are some examples of court cases involving some of the mentioned anti-abuse practices:

- a Dutch company, with a right to recover 20% of WHT under the relevant DTA (with a residual, non-recoverable rate of 15%)[59] sold 100% of shares in C. AG, a Swiss company, to X. GmbH, an Austrian company. At the time of sale, C. AG had sizeable distributable liquidity. Upon a subsequent distribution of dividends from C. AG to X. GmbH, the FTA decided that X. GmbH could not avail itself of the right to fully recover the Swiss WHT, as provided by the relevant Austrian-Swiss DTA, but that it would be limited to 20%, in application of the old reserves practice. This decision was confirmed by the Federal Administrative Tribunal ("FAT");[60]
- a Paraguayan resident individual[61] sold 100% of shares in A. SA, a Swiss company to D. SA, another Swiss company. At the time of the sale, A. SA disposed of more than CHF 750'000 in liquidity and CHF 636'174.43 of distributable reserves. A. SA having subsequently distributed a dividend of CHF 820'300, the FTA refused reimbursement of WHT to D. SA in the amount of 35% of the old reserves, i.e. of CHF 636'174.43. This decision was ultimately confirmed by the FSC;[62]
- a Liechtenstein resident "Anstalt", held by a UK resident individual sold 100% of the shares in B. SA, a Swiss real estate company, to A. SA, a Swiss resident company. On the same day of the signature of the share purchase agreement, B. SA sold its main real estate asset to a third party. Subsequently, B. SA decided a sizeable dividend to be paid to A. SA. The FTA refused A. SA's request for reimbursement of WHT in application of its "liquidation by proxy" practice. The FSC (as the FAT before it) confirmed the FTA decision and held that the transaction was abusive in the sense of article 21 (2) WHT act.[63]
- the FSC has confirmed the existence of tax avoidance and thus the refusal of the FTA to grant a WHT reimbursement in a case of international transposition in 1971 in which the foreign quotaholders sold a Swiss company at market value to another Swiss company owned by the same quotaholders.[64] In another, more recent case, of 2016, concerning the sale of shares in a Swiss company to another Swiss company by a UK resident individual, the application of the notification procedure was refused by the FTA in application of the international transposition practice. The FSC confirmed the refusal, considering that the case seemed abusive, but did not need to discuss the international transposition, as the refusal was already warranted under the old reserves practice (at

[58] FSC decision 2C_664/2013 of 28 April 2014, recital 4.2; Oesterhelt, *Rechtliche Einordnung von Steuerrulings*, SJZ 117/2021, 431 et seq., 432.

[59] Due to an "arranged-or-maintained" SAAR provided at the time in the relevant DTA between Switzerland and the Netherlands.

[60] FAT decision A-2744/2008 of 23 March 2010.

[61] There is no DTA between Switzerland and Paraguay.

[62] FSC decision 147 II 338 of 29 July 2021.

[63] FSC decision 2C_359/2022 of 13 September 2022.

[64] FSC decision of 30 April 1971, ASA 50, 512 et seq.

the time of sale the target had old reserves in an amount higher than the subsequently distributed dividend).[65]

The thin capitalization and minimum interest rules have also been upheld in court cases.[66]

It should be noted that, as regards the practices of old reserves, liquidation by proxy and international transposition Swiss courts are not bound by the administrative practices of the FTA and do not consider them as objective anti-avoidance rules. On the contrary, the general elements, including the elusive intent, of tax avoidance (see section 2.3. below), must be established in each case in order for the relevant denial of WHT reimbursement to be confirmed.[67]

2.3. Domestic General Anti-Avoidance Rule (GAAR)

Article 21 (2) WHT act constitutes a general anti-avoidance rule in connection with reclaims of WHT. While its precise legal basis has been the subject of much controversy,[68] the basic principle of prohibition of tax avoidance is a well-established principle in all areas of Swiss tax law.[69]

According to the standard definition given by the FSC, the definition of tax avoidance is constituted of three elements:[70]

1. the chosen legal arrangement appears unusual, inappropriate, or peculiar, and is completely unreasonable given the economic circumstances (objective element);
2. It must be assumed that the chosen legal arrangement was abusively made solely to save taxes that would be owed under proper circumstances (subjective element);
3. the chosen approach would actually lead to significant tax savings if accepted by the tax authority (effective element).

The FSC examines whether these conditions are met based on the specific circumstances of each individual case. If the conditions for tax avoidance are met, the taxation will be generally based on the legal arrangement that would have been appropriate to achieve the intended economic purpose. Tax avoidance is only considered in very exceptional situations, particularly when the chosen legal arrangement, aside from the tax aspects, is beyond what is economically reasonable. The subjective element is crucial, as the assumption of tax avoidance is excluded if there are reasons other than mere tax savings for the legal arrangement.[71]

[65] FSC decision 2C_597/2016 of 10 August 2017, recital 3.4.

[66] FSC decisions 142 II 355 of 3 June 2016, recitals 7.2 and 7.4; 140 II 88 of 26 November 2013.

[67] FSC decision 147 II 338 of 29 July 2021, recital 3.5; FSC decision 2C_470/2018 of 5 October 2018, recital 6.3; FSC decision 2C_551/2009 of 13 April 2010, recital 3.3; FSC decision of 30 April 1971, ASA 50, 512 et seq., recital 3; *see* also Fisler/Ergenzinger, *Das Element der Steuerersparnis bei der internationalen Transponierung*, EF 6/22, 259 et seq., s. 2.2; Brönimann, *Internationale Transponierung*, StR 2012, 567 et seq., 568; Bauer-Balmelli/Fisler, VSTGK, art. 21 N 39-64.

[68] *See* e.g. Hongler/Gmür, *Rechtsfolgen der Steuerumgehung*, StR 10/2024, 697 et seq., 698 and the references in fn. 3.

[69] FSC decision 9C_635/2023 of 3 October 2024, recital 16.1, with further references to FSC decisions in various areas of Swiss tax law.

[70] FSC decision 9C_635/2023 of 3 October 2024, recital 16.2, with further references.

[71] *Id.*; *see* also Lutz, 155-157.

No automatic penalties apply if a case of tax avoidance is established. In the realm of direct taxes, where a mixed assessment proceeding applies, penalties are generally excluded if all the relevant facts have been disclosed to the tax authority, even if the tax authority reaches a different conclusion from that of the taxpayer. In the case of WHT, where a self-assessment procedure is applicable, it is possible that penalties apply if the taxpayer (or its organs, for entities)[72] are found to have acted intentionally or negligently.[73]

2.4. Application of domestic SAARs and GAAR to treaty abuse

While there is no case in which this was directly based on the domestic anti-avoidance principle (based on article 21 (2) WHT act) and it is by now widely recognized that domestic anti-avoidance rules cannot be directly applied to treaty situations,[74] as seen, (section 2.2 above) most specific anti-avoidance practices (with the exception of international transposition and extended international transposition) are applied in the same way to domestic and international situations.[75]

An example of this would be the FAT case of 2010 concerning a liquidation by proxy case described above (section 2.2).[76]

In addition, the FSC has, for decades, also applied general anti-avoidance considerations to treaty situations, although with varying justifications and foundations.[77]

2.5. Interaction between domestic anti-avoidance rules and tax treaties

In a recent leading case of 3 October 2024, the Swiss highest court has had the occasion to carefully analyze the issue of the interaction between anti-avoidance rules and tax treaties. The case dealt with the right of WHT reimbursement of a Danish bank that held Swiss governmental bonds, which had been hedged back-to-back with a “Cross-Currency Rate Swap”.

After having corrected and limited the Swiss interpretation of the beneficial ownership requirement under the relevant DTA (see section 4.3 below on this point) and found that the appellant in this case was indeed the beneficial owner of the interest payments under the bonds,[78] the FSC confirmed its previous case law holding that all treaty benefits are subject

72 According to art. 6 of the Federal act on administrative criminal law of 22 March 1974, SR 313.0, in case of offences committed by entities it is the individual responsible that shall be punished. An exception is provided in case a fine of no more than CHF 5'000 is applicable (art. 7 of the same act).

73 *See* art. 61 WHT act.

74 FAT decision A-1246/2011 of 23 July 2012, recital 2.3; *see* also FSC decision 9C_635/2023 of 3 October 2024, recital 14; Lutz/Taddei, in Zweifel/Beusch/Matteotti, *Kommentar zum internationalen Steuerrecht*, art. 1 N 164; Bauer-Balmelli/Fisler, VSTGK, art. 21 N 58-58b.

75 *See* also FSC decision 2C_354/2018 of 20 April 2020, recital 4.2.1.

76 FAT decision A-2744/2008 of 23 March 2010.

77 *See e.g.* FSC decisions 9C_635/2023 of 3 October 2024, recital 14; 2C_354/2018 of 20 April 2020, recital 4; 2A.239/2005 of 28 November 2005, recital 3.4; FSC decision 113 Ib 195 of 10 July 1987, recital 4c; FSC decision 94 I 656 of 22 November 1968, recital 4.

78 FSC decision 9C_635/2023 of 3 October 2024, recitals 5-10.

to a general anti-abuse rule in the sense of a general prohibition of the abuse of rights.[79] It did so by applying the principles already established in investor-state dispute cases and, with reference both to the jurisprudence of the International Court of Justice ("ICJ") as well as the developments in international taxation (with particular reference to the BEPS project and the new article 29 (9) of the OECD-MA and article 7 (1) of the MLI)[80], held that the prohibition of the abuse of rights must be seen as a general principle of international law which is applicable even absent a specific provision and which is binding for individual taxpayers as well as for States.[81]

The FSC then stated, again with reference to the investor-state dispute cases and to jurisprudence of the ICJ, that the abuse of law is an exceptional corrective measure that should be applied sparingly and that it must be proven by the party invoking it.[82] After taking into account also the guidance provided by the OECD MC ("guiding principle" and PPT),[83] as well as comparing the situation of other countries, it summarized the requirements for this general anti-abuse rule inherent to international law:

a) the treaty benefit is effectively enjoyed by a person that would not be entitled to it under the treaty, i.e. that the application of a treaty benefit would not be in line with the goals of the treaty;
b) the denial of treaty benefits must be in compliance with the international law principle of good faith, which condition must be applied particularly strictly.

In the case at hand, the fact that the income streams received by the Danish bank from Swiss bonds was found to be in a close factual connection to the payments granted under the swap agreements.[84] While this circumstance was not sufficient to deny beneficial ownership of the income streams, it was obvious to the FSC that the Swiss income stream was being forwarded to parties that were not established to be entitled to treaty benefits. Therefore, granting the treaty benefit was not in line with the intentions and goals of the DTA. However, according to the FSC, this alone was insufficient to deny the treaty benefits in the specific case: additionally, it was necessary to establish that whether the denial of treaty benefits in the specific case was compliant with the international law principle of good faith. According to the FSC it would be contrary to good faith to deny treaty benefits in a situation that – under its domestic rules –would not be considered abusive.[85]

Accordingly, the FSC analyzed whether the case was to be considered as abusive under the domestic GAAR, i.e. whether the three elements of the definition (see section 2.3 above) were fulfilled. Having established that the effective element of the definition was clearly present (i.e. the availability of WHT refund), on the other two elements, the FSC found that facts had not been sufficiently established and thus returned the case to the FAT for a new determination.[86]

79 *See* FSC decision 2A.239/2005 of 28 November 2005, recital 3.4 (based mainly on the Vienna Convention on the Law of Treaties of 23 May 1969, SR 0.111, in force for Switzerland since 6 June 1990, "Vienna Convention").

80 Multilateral Convention to implement Tax Treaty related Measures to Prevent Base Erosion and Profit Shifting of 24 November 2016, SR 0.671.1, in force for Switzerland since 1 December 2019 ("MLI").

81 FSC decision 9C_635/2023 of 3 October 2024, recitals 5-10.

82 *Id*, recital 15.1.

83 *Id*, recital 15.2.

84 *Id*, recital 10.2.

85 *Id*, recital 15.6.

86 *Id*, recitals 16-17.

In sum, according to its newest case law, the FSC tests whe1ther treaty benefits may be denied in abusive situations by inquiring:

- whether the granting of a benefit is against the spirit of the treaty. It must be assumed that in case of a codified GAAR or SAAR, the question of whether such rule explicitly set forth in the treaty applies would be asked instead;[87]
- whether the case would be considered abusive also under the domestic anti-abuse reservation.

According to the FSC a treaty benefit may be denied only if both questions are resolved affirmatively.

In this context, it should be noted that, while there are already many Swiss DTAs that include the PPT and the number is expected to increase in the future, it is unlikely that a PPT would change the current Swiss anti-abuse practice in outbound cases: the MLI is not seen to force signatory States (that would be free not to impose any source taxation at all, unilaterally) to introduce stricter anti-abuse rules but only to sanction any stricter policies.[88]

This analysis seems correct. In fact, the subjective element under the Swiss general anti-abuse definition requires that the tax savings be the main goal of the abusive transaction and no abuse can be found where objectives other than tax savings play a relevant role.[89] By contrast, the PPT provided for in article 7 (1) MLI and article 29 (9) of the OECD-MC of 2017, only requires that obtaining a treaty benefit be "one of the principal purposes" of an arrangement. In addition, under the Swiss general anti-abuse doctrine, the intention to save taxes is not sufficient for an arrangement to be abusive: aside from the effective element, it is also necessary that the arrangement be qualified as unreasonable (objective element). The PPT is thus arguably farther reaching than the Swiss unilateral anti-abuse doctrine.[90]

2.6. Proposals to reform any of the domestic SAARs or domestic GAAR

Switzerland has a very high withholding tax rate, compared to most other countries,[91] as well as anti-abuse practices that are considered by many as rather aggressive and effective. The discussions are thus generally aimed at easing requirements for relief at source, e.g. in a corporate group context, rather than strengthening source-based taxation.

One proposal that has been recently analyzed in a report written by the Swiss government (upon request by the Swiss parliament) concerns the abandonment of the theory of direct beneficiary in favor of the triangle theory (see above, section 2). The Swiss government estimates that a change of system would most likely bring advantages to Swiss companies and their shareholders but at the same time would reduce the fiscal revenue

87 *See* Malek, *L'introduction du «principal purpose test» en Suisse: analyse et recommandations*, FStrR 2019, 107 et seq., s. 4.5.1.; Oesterhelt, IStR, § 24 N 10; FSC decision 2C_880/2018 of 19 May 2020, recital 4.5.4.

88 Oesterhelt, IStR, § 24 N 15-17; Oesterhelt/Oppliger, § 6 N 19-22; Lutz, 209-210; see also Dispatch 17.068 of the Federal council to Parliament of 15 November 2017 concerning the ratification of the DTA between Switzerland and Kosovo, BBl 2017 7767, 7775.

89 FSC decision 2C_354/2018 of 20 April 2020, recital 4.2.1, with further references.

90 See also Harbeke, Zur Debatte "Nutzungsberechtigung und Finanzinstrumente", FStrR 2024, 154 et seq., s. 5.

91 *See* e.g. OECD, Corporate Tax Statistics 2024, 28-30, https://doi.org/10.1787/9c27d6e8-en.

from the WHT. For this reason, in the mentioned report, the Swiss government opposes the request for change.[92]

3. Typical treaty abuse situations in Switzerland

3.1. Cases involving treaty shopping

Although Switzerland has an extensive DTA network, there are countries with which there are no DTAs (e.g. Cayman Islands, the Channel Islands, Bermuda, Monaco, etc.) and countries in relation to which no 0% residual WHT rate is available for dividends under the relevant treaty (e.g. the USA)[93]. This, combined with the high WHT rate of 35% on dividends, can incentivize treaty shopping practices.[94]

An example of a treaty shopping case would be the one that led to the FSC decision of 28 November 2005.[95] The case involved a Swiss operating company that was held by a Danish company, which in turn was 100% held by a Bermuda company (indirectly via a Guernsey company), with the ultimate beneficial owner also being a Bermuda resident. In that case. the FTA rejected the request of the Danish company for WHT reimbursement under the applicable Danish-Swiss DTA,[96] which provided in article 10 (1) for the exclusive right to tax dividends attributed to the State of residence. This feature of the Danish-Swiss DTA was explicitly recognized by the FSC as a particular incentive for treaty shopping.[97]

In application of the principle of good faith set forth in article 26 of the Vienna Convention, the FSC held that the Danish-Swiss DTA, which did not contain any explicit anti-avoidance rules, contained an implicit prohibition of treaty abuse.[98] The FSC then considered that the Danish company was controlled by companies that could not avail themselves of WHT relief under a DTA and that the Danish company did not have any substance or genuine economic activity,[99] and that it was effectively a mere shell company. As a consequence, the request for WHT reimbursement was considered abusive and the denial of reimbursement upheld.[100]

92 *See* Swiss Federal council, report “Benachteiligung von Schweizer Unternehmen durch eine einheitliche Besteuerungspraxis vermeiden” [avoiding disadvantages for Swiss entities through a coherent practice of taxation] of 16 December 2024] in response to the parliamentary request 22.3396 of the Commission on levies and economy of the national council, available at https://backend.efd.admin.ch/fileservice/sdweb-docs-prod-efdadminch-files/files/2024/12/13/aa832a03-3b07-4baa-a227-441069b14300.pdf.

93 *See* Convention between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with respect to Taxes on Income of 2 October 1996, SR 0.672.933.61, art. 10 (2) a (residual tax rate assigned to the source state of 5%).

94 Lutz, 5-6; Matteotti/Krenger in Zweifel/Beusch/Matteotti, *Kommentar zum internationalen Steuerrecht*, art. 1 N 66-68.

95 FSC decision 2A.239/2005 of 28 November 2005.

96 Convention between the Swiss Confederation and the Kingdom of Denmark for the Avoidance of Double Taxation with respect to Taxes on Income and Capital of 23 November 1973, SR 0.672.931.41.

97 FSC decision 2A.239/2005 of 28 November 2005, recital 3.1.

98 *Id*, recital 3.4.

99 *Id*, recital 3.6.2, with reference to N 14 and 21 of the Commentary to Article 1 of the OECD MC (version of 1995) and N 14 and 21 of the Commentary in the version of 2003.

100 *Id*, recital 4.

3.2. Cases involving indirect transfers

As an example of abusive indirect transfer we can mention a case by the Administrative tribunal of the Canton of Zurich of 2013.[101]

E. AG was a Swiss real estate company. 100% of its shares were held by a Luxemburg company, A. A. was in turn held by a BVI company. The shareholder of the BVI company was an individual, M, but the facts of the case do not disclose his tax residence.

The relevant Luxembourg-Swiss DTA[102] assigned exclusive taxation rights on capital gains from the alienation of movable property other than real estate to the State of residence of the seller (article 13 (4)). The DTA CH-LUX did not contain a clause comparable to article 13 (4) of the current OECD-MC equating real estate companies to real estate.

Under domestic law, the gain from the transfer of a real estate company could be taxed in the Canton in which the real estate was situated, as if the real estate itself had been sold (real estate capital gains tax).

Referring to the FSC decision of 2005 discussed above in section 3.1, the court held that also the DTA CH-LUX was to be interpreted as containing an implied prohibition of treaty abuse. It then considered that A. did not have any substance or genuine economic activity and that it was to be considered as a mere shell company.[103] Therefore, the court concluded that A. had only been interposed between the BVI company and E. AG in order to benefit from the benefits granted by the DTA CH-LUX, an arrangement that the court considered to be artificial.[104] This conduct was therefore considered abusive and the treaty protection denied.[105]

3.3. Cases involving surplus stripping

As Switzerland does not levy any source withholding tax on capital gains but does on dividends, surplus stripping cases are targeted by specific anti-avoidance practices such as the old reserves, liquidation by proxy and international transposition practices (see section 2.1 above). Examples of surplus stripping cases would be the cases described in section 2.2 above, e.g. the sale of a Swiss company by a Paraguayan resident to a Swiss company,[106] or the sale of a Swiss company by a Dutch entity to an Austrian one.[107]

3.4. Cases involving other forms of treaty abuse to avoid source-based taxation

Not applicable.

101 Zurich Administrative Tribunal, decision of 18 December 2013, case no. SB.2012.00088.

102 Convention between the Swiss Confederation and the Grand Duchy of Luxembourg for the Avoidance of Double Taxation with respect to Taxes on Income and Capital of 21 January 1993, SR 0.672.951.81 ("DTA CH-LUX ").

103 Zurich Administrative Tribunal, decision of 18 December 2013, case no. SB.2012.00088, recitals 18-25.

104 *Id*, recital 25.

105 *Id*.

106 FSC decision 147 II 338 of 29 July 2021.

107 FAT decision A-2744/2008 of 23 March 2010.

Part II

4. Treaty-based SAARs

4.1. Treaty-based SAARs in Switzerland's tax treaties

Until the signing and implementation of the MLI, Swiss DTAs had a number of different specific anti-avoidance rules.[108] The main categories are as follows:

- Anti-base erosion rules inspired by the existing Swiss unilateral anti-abuse measures historically existing for inbound cases, denying benefits in particular in the case of forwarding items of income via interest or other payments to parties not resident in a contracting State (e.g. article 23 of the DTA CH-IT;[109] article 28 of the DTA CH-BE[110]; article 14 of the DTA CH-FR[111]);[112]
- Anti-conduit rules (i.e. targeting "conduit arrangements"), generally combined with derivative benefits clauses (e.g. paragraph 5 of the DTA CH-CL);
- Limitation of benefits clauses (see section 4.6 below);
- Explicit reservations of domestic anti-abuse rules (e.g. article 23 of the DTA CH-DE;[113]article 9 of the EU-Swiss AEoI Agreement);
- The most recent pre-MLI Swiss treaty practice consisted in specific "principal purpose"[114] clauses for the articles concerning dividends, interests and royalties in combination with a derivative benefits clause,[115] e.g. the clause agreed in the 2014 DTA with Iceland.[116] The clause provided for denial of treaty benefits under articles 10-12 and 21 as well the 0% under article 10 (3) where the "main purpose" of the conclusion of a transaction or establishment of an entity was to obtain treaty benefits. Benefits could still be granted under paragraph 4 (c) of the Protocol if ignoring the arrangement that the item of income was assigned to a person that had equivalent or more favorable benefits under the DTA or under another agreement.

108 See LUTZ, 166-258 for a comprehensive list; *see also* OBERSON, Précis de droit fiscal international, N 799-942; MATTEOTTI/KRENGER in Zweifel/Beusch/Matteotti, *Kommentar zum internationalen Steuerrecht*, art. 1 N 72.

109 Convention between the Swiss Confederation and the Italian Republic for the Avoidance of Double Taxation with respect to Taxes on Income and Capital and for the Regulation of certain other Issues of 9 March 1976, SR 0.672.945.41 ("DTA CH-IT").

110 Convention between the Swiss Confederation and the Kingdom of Belgium for the Avoidance of Double Taxation with respect to Taxes on Income and Capital of 28 August 1978, SR 0.672.917.21 ("DTA CH-IT").

111 Convention between Switzerland and France for the Avoidance of Double Taxation with respect to Taxes on Income and Capital and to prevent Tax Fraud and Avoidance of 9 September 1966, SR 0.672.934.91 ("DTA CH-FR").

112 *See generally* OBERSON, Précis de droit fiscal international, N 836-841; SIMONEK/BECKER, BEPS Action 6: *Verhinderung von Abkommensmissbrauch mit dem Principal Purposes Test – Implikationen und Handlungsbedarf für die Schweiz?*, FStrR 2016, 107 et seq., s. 5.1 ("SIMONEK/BECKER").

113 Convention between the Swiss Confederation and the Federal Republic of Germany for the Avoidance of Double Taxation with respect to Taxes on Income and Capital of 11 August 1971, SR 0.672.913.62 ("DTA CH-DE").

114 SIMONEK/BECKER, s. 5.1.; *see also* LUTZ, 186-187 (considering this an "arranged-or-maintained" clause).

115 Dispatch 14.080 of 12 November 2014 of the Federal council to Parliament concerning the approval of a new DTA between Switzerland and Iceland, BBl 2014 8941, 8950; SIMONEK/BECKER, Section 5.1.

116 Para 4 of the Protocol annexed to the Convention between the Swiss Confederation and Iceland for the Avoidance of Double Taxation with respect to taxes on Income and Capital of 10 July 2014, SR 0.672.944.51 (in the version in force until 15 December 2022).

As Switzerland has opted for the adoption of a PPT under the MLI,[117] in most cases, the above-mentioned rules have been and can be expected to be replaced by the PPT clause in the wake of the implementation of the MLI.[118]

Outside of the scope of dividend, interest and royalty payments, there are some SAARs that should not be affected by the PPT, such as:

- specific provisions dealing with individuals that are subject to preferential tax regimes such as lump-sum taxation or remittance-basis taxation. For remittance basis taxation countries, the DTAs generally require for an individual to be considered as a resident under article 4 of the respective treaty, and that the item of income subject to source taxation be remitted (and taxed) in the State of residence. For lump-sum taxed individuals the treaties generally include a provision according to which a lump-sum taxed person is only considered as a resident under the treaty if all the elements of income from the source State are subject to ordinary taxation;[119]
- the specific provision of article 17 (2) of the OECD MC designed to tackle cases of avoidance of the allocation rules for entertainers and sportspersons is present in most Swiss DTAs;[120]
- a specific 80% holding requirement combined with a limitation of benefits clause for access to the 0% withholding tax on dividends in article 10 (3) of the CH-AUS DTA;[121]
- a minimum holding period for access to the reduced residual withholding tax rate on dividends (19 Swiss DTAs and the EU-Swiss AEoI Agreement feature a holding period between 6 and 24 months).[122]

4.2. The relevance of the UN Model in Switzerland's tax treaties

Generally speaking, the Swiss DTA policy is to follow the OECD MC, with some exceptions, expressed in the (few) reservations made by Switzerland to the OECD MC or its Commentary.[123]

Nevertheless, there are examples of DTAs (mainly with developing countries) that include some limited features originating from the UN Model Tax Convention. As example, there are several DTAs that attribute a concurring taxing rights to the source State for royalty payments (even though domestically Switzerland does not levy WHT on such payments).[124]

[117] Dispatch 18.063 of 22 August 2018 of the Federal council to Parliament concerning the ratification of the MLI, BBl 2018 5389, 5410-5411.

[118] See e.g. Dispatch 18.063 of 22 August 2018 of the Federal council to Parliament concerning the ratification of the MLI, BBl 2018 5389, 5410-5411; Dispatch 18.062 of 22 August 2018 of the Federal council to Parliament concerning the approval of the Amending Protocol for the DTA between Switzerland and the UK, BBl 2018 5507, 5511-5512; *see* also the Swiss notifications on art. 7 MLI.

[119] *See* Seiler in, IStR, § 4 N 9.

[120] Oberson, Précis de droit fiscal international, N 704-705.

[121] Convention between the Swiss Confederation and Australia for the Avoidance of Double Taxation with respect to taxes on Income of 30 July 2013, SR 0.672.915.81; see also Lutz, 167-169.

[122] Oesterhelt/Oppliger, § 5 N 19; Oesterhelt/Opel, Haltedauer im Abkommensrecht, FStrR 2021, 121 et seq., s. 2.3.1.

[123] *See* Hongler, IStR, § 2 N 168; Matteotti/Krenger in Zweifel/Beusch/Matteotti, *Kommentar zum internationalen Steuerrecht,* Introduction N 70.

[124] *See* Müller/Linder in Zweifel/Beusch/Matteotti, *Kommentar zum internationalen Steuerrecht*, art. 12 N 50-51.

A relatively low number of DTAs includes a service permanent establishment,[125] and only one DTA grants the source State concurring taxing rights on other income.[126]

4.3. The beneficial ownership requirements in articles 10, 11 and 12 of the OECD Model

The beneficial ownership requirement is explicitly mentioned in many Swiss DTAs in relation to the articles dealing with dividends, interests and royalties.[127]

Irrespective of its codification in a tax treaty, however, the FSC has decided in a landmark decision of 2015 that the requirement of beneficial ownership is implied even if not explicitly set forth in a DTA.[128] In that decision, the FSC left the question of whether the concept of beneficial ownership may be treated as an anti-avoidance rule explicitly open.[129]

The concept of beneficial ownership has, however, been expanded by the FSC in subsequent decisions. In the 2015 decision, the FSC, referring to the OECD MC Commentary, established that the beneficial owner must have a right to use and enjoy the dividend without being constrained by any contractual or legal obligation.[130] However, the FSC added that factual or economic constraints could lead to consider the recipient of the dividend as not being the beneficial owner, which could be the case – even absent a legal obligation – if the company resident in the treaty State forwards the received dividend to its controlling shareholder (residing outside of the treaty State). Based on this consideration, the FSC considered, applying an economic, "substance-over-form" approach, that in "stepping-stone" structures the recipient has no control over the use of income and is therefore not the beneficial owner.[131]

This rather narrow interpretation of the concept of beneficial ownership was corrected in subsequent decisions. In a decision of 2020, the FSC stated, with reference to the applicable parts of the OECD MC Commentary (in the 2014 version) that simple factual constraints could justify denying the beneficial ownership of a recipient of items of income, but that such factual constraints could constitute indicia for the existence of a contractual or legal obligation to forward the payment received.[132]

Lastly, in a recent landmark decision, the FSC reaffirmed the need to use a more legal and less economic concept of beneficial ownership.[133] It also limited the scope of the factual indicia that could be relevant to assess whether a legal obligation to forward the income existed (e.g. if the relevant contractual law does not allow for non-written addenda to the agreement),[134] and underscored the importance of the distinction between the concept of

[125] *See* DENGER/HUG, *Dienstleistungsbetriebsstätte in schweizerischen DBA*, EF 10/2020, 761 et seq.; SCHREIBER/HONOLD/JAUN in Zweifel/Beusch/Matteotti, *Kommentar zum internationalen Steuerrecht*, art. 5 N 16-19.

[126] HELBING/HÄNI in Zweifel/Beusch/Matteotti, *Kommentar zum internationalen Steuerrecht*, art. 21 N 83.

[127] *See* e.g. the list provided in LUTZ, 32, fn. 141; *see* also BAUER-BALMELLI/VOCK, in Zweifel/Beusch/Matteotti, *Kommentar zum internationalen Steuerrecht*, before art. 10-12 N 16.

[128] FSC decision 141 II 447 of 5 May 2015, recitals 4-5.

[129] *Id*, recital 4.5.

[130] *Id*, recital 5.2.1.

[131] Id, recitals 5.2.2-5.2.5; *see* also MALEK, *L'introduction du «principal purpose test» en Suisse: analyse et recommandations*, FStrR 2019, 107 et seq., s. 4.3.1.

[132] FSC decision 2C_880/2018 of 19 May 2020, recitals 4.3.-4.4.

[133] FSC decision 9C_635/2023 of 3 October 2024, recital 8.

[134] *Id*, recital 9.2.1.

beneficial ownership, on one hand, and the concept of treaty abuse, on the other.[135]

As a consequence, it should be assumed that in group structures the mere fact that the recipient company is controlled by another company in another State, as evidenced also by interdependencies at the level of the members of governing bodies, should not be sufficient to dispute beneficial ownership.[136]

4.4. Entities considered as transparent from the source state

Switzerland has not adopted article 3 of the MLI and has notified a reservation under article 5 (a) of the MLI. There are also generally no particular hybrid mismatch rules. However, according to the jurisprudence of the FSC, the tax treatment abroad may play a role when assessing whether an entity should be considered as transparent or non-transparent under Swiss tax law.[137]

By contrast, in approximately half of the Swiss DTAs, partnerships are explicitly included in the definition of resident persons.[138] Furthermore, there are competent agreements in place with various treaty states that allow domestic collective investments schemes to obtain treaty benefits in the name of the investors at certain conditions.[139]

4.5. Hybrid entity and tax planning opportunities

See section 4.4 above.

4.6. Limitation on benefits (LOB)

Switzerland has two active DTAs that include more or less fully fledged LOB provisions: the DTA CH-US[140] and the DTA CH-JP.[141] Both are substantially based on the relevant US Model Convention at the time of the agreement.

It should be noted that the DTA CH-JP has been amended in 2022 to implement the BEPS Action 6 minimum standard. Since then, a PPT has been added in addition to the LOB provision.[142]

135 *Id*, recital 8.3.

136 Oesterhelt, IStR, § 19 N 52-58; see also Danon/Malek, *Influence of EU case law on the prohibition of international tax abuse in Swiss practice,* ASA 89, 477 et seq., 500.

137 FSC decision 2C_894/2013 of 18 September 2015, recital 3.

138 Peter in Zweifel/Beusch/Matteotti, *Kommentar zum internationalen Steuerrecht*, art. 1 N 40.

139 See FTA. Circular letter 24 of 20 November 2017, s. 2.11 and Annexes III and IV.

140 Convention between the Swiss Confederation and the United States of America for the Avoidance of Double Taxation with respect to Taxes on Income of 2 October 1996, SR 0.672.933.61 ("DTA CH-US").

141 Convention between Switzerland and Japan for the Avoidance of Double Taxation with respect to Taxes on Income of 19 January 1971, SR 0.672.946.31 ("DTA CH-JP ") (the LOB clause, Article 22A, was included with Amending Protocol of 21 May 2010, in force since 30 December 2011).

142 Para 1 of the Protocol to the DTA CH-JP.

4.7. Other SAARs in Switzerland's tax treaties

See section 4.1. above.

5. Treaty GAAR

5.1. Principal Purpose Test (PPT)

Currently, there are 29 Swiss DTAs that include a PPT within the meaning of article 7 of the MLI. Many more are in the process of being revised.[143]

5.2. The "guiding principle" in OECD Commentary, article 1 paragraph 61

In the landmark decision of 3 October 2024 mentioned above (section 2.5 above) the "guiding principle" mentioned in the OECD Commentary to the OECD MC (article 1 N 61) has been cited in connection with the PPT rule.[144] As already done in the decision of 2005,[145] the "guiding principle" was one of the foundations to justify the implied prohibition of treaty abuse as a fundamental principle of international law.

While the "guiding principle" is included in the Commentary and thus may be used (and has been used by the FSC in the mentioned decision) as an interpretation aide, whereas the PPT, upon implementation in a DTA, is an actual treaty GAAR,[146] the distinction should not be particularly relevant to the Swiss treaty anti-avoidance practice (see above, section 2.5.).

5.3. The relationship between domestic GAAR and tax treaty GAAR

No cases yet exist that deal with the relationship between a treaty PPT within the meaning of article 7 MLI/article 28 (9) of the OECD MC and the domestic GAAR (prohibition of tax avoidance). As explained in section 2.5 above, from a Swiss perspective the domestic GAAR is seen imposing a higher threshold for abuse than the PPT. Therefore, and since under the Swiss understanding, as established in the FSC decision of 3 October 2024,[147] both GAARs must be cumulatively applicable for treaty benefits to be denied, no relevant change in the Swiss treaty practice should be expected with the introduction of the PPT.

143 See also OECD, Prevention of Tax Treaty Abuse – Sixth Peer Review Report on Treaty Shopping: Inclusive Framework on BEPS: Action 6, available at https://doi.org/10.1787/36cebf8e-en, 286-289.

144 FSC decision 9C_635/2024 of 3 October 2024, recital 15.2.

145 FSC decision 2A.239/2005 of 28 November 2005, recital 3.4.5. with reference to N 9.2-9.5 of the OECD Commentary to the OECD MC of 2003.

146 *See* Danon, Treaty Abuse in the Post-BEPS World: Analysis of the Policy Shift and Impact of the Principal Purpose Test for MNE Groups, BIT January 2018, 31 et seq., s. 2.3.2.

147 FSC decision 9C_635/2024 of 3 October 2024, recitals 15-16.

6. Potential conflicts of rules (ordering of rules)

6.1. SAAR or GAAR

A majority of Swiss scholars deem that the decisive factor is whether a specific situation is covered by a SAAR. In that case, there should be no room to apply the PPT even though the SAAR has been complied with.[148]

However, Swiss case law in connection with domestic SAAR legislation for direct taxes suggests that SAARs never intend to cover all possible abusive situations and that the general prohibition of tax avoidance remains applicable.[149] It is the opinion of the author that it is likely that Swiss courts would take the same approach if it came to a conflict between a treaty SAAR and a treaty GAAR.

6.2. Case law regarding the interplay between tax treaty SAARs and tax treaty GAAR

There does not seem to be specific Swiss case law on this point.

7. Examples of treaty abuse

7.1. Scenario 1 – Treaty shopping

In this case, any distributable non-operational assets existing in S. Co at the time of the reorganization would be "tainted" under the "old reserves" doctrine (see section 2.1.3.) above and could not benefit of the lower 5% residual WHT rate.

In light of the most recent decision of the FSC on treaty abuse (section 2.5 above) in order to deny the additional WHT relief up to 5% residual WHT rate the transaction would need to fall both under the PPT under article 28 (9) of the DTA (which is assumed to follow the 2017 OECD MC) and under the general domestic anti-avoidance rule.

As regards the old reserves there is little doubt that this would be the case: the tax savings would necessarily be regarded as a main purpose of the reorganization and it is unlikely, in light of FSC case law, that economic or non-tax reasons could be seen to justify the reorganization without previous distribution of the old reserves.

As regards future profits, the question of availability of the treaty benefit in form of a 5% residual WHT rate from a Swiss point of view would revolve around whether H. Co has sufficient substance (see section 1.2 above).[150]

[148] *See* Danon, *Treaty Abuse in the Post-BEPS World: Analysis of the Policy Shift and Impact of the Principal Purpose Test for MNE Groups*, BIT January 2018, 31 et seq., s. 4.8; Malek, s. 4.1 with further references.

[149] *See* e.g. FSC decisions 142 II 399 of 18 July 2016, recitals 3.4 and 4; 2C_168/2017 of 26 October 2017, recitals 3-4; 9C_679/2021 of 20 April 2023, recital 2.

[150] See also Lutz, 210-211.

7.2. Scenario 2 – Thin capitalization

The author's understanding of the premise of this scenario is that the *Lexel* case dealt with thin capitalization rules that limited the deduction of interest notwithstanding that the interest was at arm's length.

As mentioned in sections 2.1.1 and 2.1.2. above, Swiss thin capitalization and interest limitation rules are merely "safe harbor" rules that do not apply whenever the taxpayer can show that the applied loan-to-value and/or interest rate is at arm's length.

Moreover, outside of the already mentioned safe harbor rules, there is generally no concept in Swiss anti-avoidance case law of second guessing taxpayers' business decisions in terms of "rationality of the structure", such as reviewing the ratio of debt versus equity financing.

7.3. Scenario 3 – Fat capitalization

Not applicable.

7.4. Scenario 4 – Transparent and/or hybrid entities

As R Co Ltd. is considered tax transparent (and thus not liable to tax) in State R, it would not qualify as a resident under article 4 of the applicable tax treaty and could therefore not enjoy treaty protection under article 10 of the DTA.[151]

But even if R Co were to be treated as a resident of R, under the current Swiss treaty-abuse practice treaty benefits could be denied if R was found to not have sufficient substance (see section 1 above).

7.5. Scenario 5 – Surplus stripping

Sub-scenario a)

As long as the interest rates are in line with the safe harbor rules or at arm's length and the royalty payments are also at arm's length, it seems unlikely that the setup would be considered abusive from a Swiss perspective. Nevertheless, should S. Co remain not profitable for a longer period of time, the Swiss tax authorities could treat this as an indication that the arm's length principle is not complied with.

151 See on this topic the guidance published by the Swiss Conference of Tax Authorities SSK of 6 September 2011 (Praxishinweise zur steuerlichen Behandlung der US-amerikanischen Limited Liability Company bei den direkten Steuern [Practical guidance on the tax treatment of US LLCs for direct taxes]), available at https://www.ssk-csi.ch/fileadmin/dokumente/Unternehmenssteuern/praxishinweise_steuerliche_behandlung_us_llc_2011_d.pdf. *See* also Oesterhelt, IStR, § 19 N 68.

Sub-scenario b)

The interest-free loans would be partially re-qualified as hidden profit distributions under the minimum interest rules (see section 2.1.2. above). In application of the theory of direct beneficiary (see section 2 above), the residual WHT rate applicable for the DTA between the country of residence of the sister company and S. Co. would apply, taking into account that the sister company is not a shareholder of S. Co. and thus no reduced residual rate under article 10 (2) (a) of a DTA similar to the OECD MC would be available.

Sub-scenario c)

Assuming that the company is subsequently de facto liquidated, this would be a case of application of the liquidation by proxy (see section 2.1.4. above) and thus abusive. Therefore, the WHT exemption would be denied to the intermediary.

Part III

8. Dispute resolution mechanism

8.1. Mutual agreement procedure (MAP)

The Swiss competent authority (State Secretariat for International Finance, "SIF") frequently deals with MAP procedures. According to statistical data available on the OECD website, in 2023, 259 MAP cases were initiated (96 transfer pricing, "TP" cases and 163 other cases) and 258 were closed (103 TP cases and 155 other cases). The highest number of active cases in 2023 was in relation to Germany, with a sizeable amount of cases open with Italy, India, Spain, France and the UK.[152]

8.2. Arbitration

Currently 37 Swiss DTAs provide for arbitration.[153] Tax treaty arbitration cases are generally treated as confidential and no statistical data exists, to the knowledge of the author. According to a scholarly contribution of 2020 by a member of the Swiss competent authority, there had been a total of five cases to go through arbitration.[154]

The DTAs generally provide that the arbitration procedure shall be set forth by mutual

[152] *See* 2023 MAP statistics for Switzerland, available at https://www.oecd.org/content/dam/oecd/en/topics/policy-issue-focus/map-statistics/map-statistics-switzerland.pdf.

[153] See OECD, Making Dispute Resolution More Effective – MAP Peer Review Report, Switzerland (Stage 2), Annex A, available at https://doi.org/10.1787/77ab98a6-en, considering also the arbitration clauses entered into force since then (without most-favored nation effects).

[154] Rolle, *Arbitration in Transfer Pricing: Issues and Solutions*, FStrR 2020, 117 et seq., s. 4.3.

agreement. As of now, only a handful of such mutual agreements have been published by the Swiss competent authorities and all provide for "final offer" arbitration.[155]

With one exception, the question of abuse does in general not appear to be grounds which would lead to denying access to arbitration.[156]

8.3. Other dispute resolution mechanisms (e.g., mediation) available

No other relevant dispute resolution mechanisms are generally available under Swiss DTAs.

Part IV

9. Policy

9.1. The importance of source-based taxation

As a capital export country, the Swiss policy has traditionally been to reduce the taxation rights of source States whenever possible.[157] Switzerland is also generally seeking to expand the availability of the 0% tax rate on dividends.

However, unrecovered or unrecoverable WHT amounts to a significant portion of tax receipts of the Swiss confederation. For the year 2023, the amount was approximately CHF 6.4 billion, out of total fiscal revenues of CHF 74.7 billion, i.e. approximately 8.6%.[158]

In a report of 13 December 2024 drafted for a parliamentary commission, the Swiss government considered that a change of practice in connection with the "direct beneficiary" principle, while beneficial for multinational enterprise groups, would increase the risk of profit shifting towards other countries and would diminish tax revenues for the Swiss confederation. As a consequence, the Swiss government took position against a change from the "direct beneficiary" to the "triangle" principle.[159]

[155] See e.g. the mutual agreement between the Swiss and UK competent authorities of 16 June 2021, available at: https://www.estv.admin.ch/dam/estv/de/dokumente/international/laender/int-laender-uk-verstaendigungsvereinbarung-uk-ch-20120614-de.pdf.download.pdf/int-laender-uk-verstaendigungsvereinbarung-uk-ch-20120614-de.pdf.

[156] See Rolle, *Arbitration in Transfer Pricing: Issues and Solutions*, FStrR 2020, 117 et seq., s. 4.2, with reference to art. 25(6)(b) of the Convention between the Swiss Confederation and the Kingdom of Norway for the Avoidance of Double Taxation with respect to Taxes on Income and Capital of 7 September 1987, SR 0.672.959.81.

[157] See e.g. FAT decision A-2744/2008 of 23 March 2010, recital 3.4 and references.

[158] See financial report on the annual account 2023 of the Swiss confederation, 9 and 45, available at https://www.efv.admin.ch/dam/efv/de/dokumente/Finanzberichte/finanzberichte/rechnung/2023/band-1b-2023.pdf.download.pdf/SR%20Staatsrechnung%20-%20Band%20Ib_DE.pdf.

[159] *See* Swiss Federal council, report "Benachteiligung von Schweizer Unternehmen durch eine einheitliche Besteuerungspraxis vermeiden" [avoiding disadvantages for Swiss entities through a coherent practice of taxation] of 16 December 2024] in response to the parliamentary request 22.3396 of the Commission on levies and economy of the national council, available at https://backend.efd.admin.ch/fileservice/sdweb-docs-prod-efdadminch-files/files/2024/12/13/aa832a03-3b07-4baa-a227-441069b14300.pdf.

9.2. The OECD BEPS work

Switzerland actively participated in the BEPS work and has agreed to all final reports to the various Actions. It has also signed and ratified the MLI, and adopted the minimum standards of Actions 5, 6, 13 and 14.[160]

9.3. Improper use of tax treaties

Treaty abuse is not a very controversial political topic in Switzerland. As shown in this paper, it has been the object of a long development in case law, but it is not a source of great concern for the Swiss government. This is also shown in the decision not to go beyond the minimum standard as regards BEPS Action 6.[161]

9.4. MLI

Not applicable.

Part V

10. Beyond – how to counteract improper use of tax treaties in the future

10.1. Initiatives to strengthen anti-abuse measures under domestic law and/or in tax treaties

There has been no particular governmental or legislative decision to strengthen anti-abuse measures as regards international taxation in Switzerland. However, there seems to be a tendency to higher litigation by the FTA in international WHT tax standards and the FTA has adopted new anti-abuse practices such as the extended international transposition (section 2.1.5 above).

10.2. The Subject-To-Tax-Rule (STTR) from Pillar Two in tax treaties

To date there have been no official communications on Swiss treaty policy as regards the STTR and has not yet signed the STTR multilateral instrument.

160 *See* e.g. Dispatch 18.063 of 22 August 2018 of the Federal council to Parliament concerning the ratification of the MLI, BBl 2018 5389.

161 *See* Dispatch 18.063 of 22 August 2018 of the Federal council to Parliament concerning the ratification of the MLI, BBl 2018 5389, 5400.

10.3. Protecting source-based taxation by providing a floor for tax competition

Switzerland actively participates in the Inclusive Framework on BEPS. It has implemented the Swiss supplementary tax (QDMTT) as of 1 January 2024 and will introduce the income inclusion rule (IIR) as of 1 January 2025.

The reasons for implementing Pillar Two in Switzerland are not so much related to the desire to protect source-based taxation in general, but rather not to lose competitiveness as a hub for multinational enterprises and to prevent foreign IIRs or UPTRs.[162]

[162] *See* the Dispatch 22.036 of the Swiss Federal council to the Swiss Parliament of 22 June 2022 concerning a Federal decree on special taxation of large company groups, BBl 2022 1700; *see* also the Q&A of the Federal department of finance on Pillar Two, available at https://www.efd.admin.ch/de/umsetzung-oecd-mindeststeuer-schweiz.

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