

Switzerland proposes changes related to relief from Swiss withholding tax under its international tax treaties

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Background

Switzerland's tax treaty network currently contains approximately 100 tax treaties concluded with various nations. Except for the area of administrative assistance, only a few national legal regulations exist in Switzerland regarding the national implementation and application of the tax treaties it has concluded. Some questions surrounding the implementation and application of tax treaties are regulated by the currently applicable *Federal Law on the Implementation of International Tax Treaties* (the Original Law), as well as its corresponding ordinances.

The Original Law entered into force in 1951 and has not undergone any significant changes since that time. The Original Law currently contains four articles authorizing the Swiss Federal Council to issue additional regulations via the enactment of ordinances in the following areas (cf. art. 2 of the original Law):

- ▶ Organization of the procedure regarding the refund of Swiss withholding taxes levied on capital income where such refund has been guaranteed by an international treaty
- ▶ Taking measures to prevent a full or partial refund of foreign withholding taxes to persons not eligible for such refund under the relevant international treaty¹

- ▶ Decisions and decrees regarding another treaty nation's taxes, to bring them under Swiss Federal administrative jurisdiction and to equate their enforceability to decisions regarding Swiss Federal taxes, with such decisions and decrees to be made by the Swiss Federal Tax Administration in the context of a double tax treaty
- ▶ Determination of the process regarding the credit of a foreign tax for Swiss tax purposes, as agreed in a relevant international treaty²
- ▶ Application of the penal provisions as contained in the Federal tax laws to the violation of the implementation rules
- ▶ Determination of the requirements for the Swiss branch of a foreign entity which is subject to ordinary taxation both at the Federal and the cantonal/communal levels to avail itself of a flat-rate tax credit on foreign income subject to non-refundable taxes

As international tax regulations constantly evolve and due to OECD's³ BEPS⁴ project, the Original Law no longer meets all of the requirements for such legislation in today's tax environment. Switzerland has, therefore, taken actions to significantly revise the Original Law.

The main areas to be revised are:

- ▶ *National regulation of the process of mutual agreement procedures (MAP)*: International tax treaties focus solely on the implementation of MAP between treaty parties. Under current Swiss legislation, important national procedural questions surrounding MAP, such as rights and obligations of the taxpayer, deadlines, and implementation of such a mutual agreement, have not been regulated. While Swiss tax authorities have developed standing practices around these questions, there has been dissent at times between involved authorities. Therefore, a regulation on the Federal level is being sought.
- ▶ *Relief from Swiss withholding tax*: Currently, there is no legislative basis for the process around relief from Swiss withholding tax based on an international tax treaty, although certain points have been regulated by way of ordinance. Some of the provisions contained in Switzerland's domestic *Withholding Tax Act (WHTA)* are applied in analogy. In addition, there is currently no clear domestic legislative basis to prevent and punish unjustified relief from such taxes, the endangerment of an international treaty's legal implementation or violations regarding the crediting of foreign residual taxes in Switzerland. Therefore, the revision of the Original Law also focuses on the process of relief from Swiss withholding tax as well as the introduction of penal provisions.

- ▶ *Secrecy*: By now, the implementation of international tax treaties falls not only under the purview of the Swiss Federal Tax Administration (SFTA) but involves a number of other authorities. It is, therefore, imperative that all involved authorities are subject to the same rules of secrecy.

The following section details the proposed changes to the Original Law as they relate to the aforementioned points regarding relief from Swiss withholding tax.

Proposed changes relating to relief from Swiss withholding tax

Pursuant to the proposed changes, the new *Federal Law on the Implementation of International Tax Treaties* (the Draft Law) would introduce:

- ▶ Legislation regarding the full or partial relief from Swiss withholding tax
- ▶ Penal provisions relating to unjustified relief from and endangerment of Swiss withholding tax, the endangerment of Swiss individual and corporate income taxes as well as violations regarding the crediting of foreign residual taxes in Switzerland

Procedural provisions

The provisions regarding full or partial relief from Swiss withholding tax are based on the domestic procedural principles contained in the Swiss WHTA and therefore apply to both, the refund of Swiss withholding tax and the reduction of Swiss withholding tax levied at source to the rate agreed in a relevant international tax treaty.

The SFTA is responsible for the process of relief from Swiss withholding tax based on an applicable double tax treaty and may, to this end, issue general directives and necessary decrees in specific cases. In addition, the SFTA will continue to be responsible for determining the modalities of filing a reclaim application, such as designating the relevant forms, questionnaires and determining the evidentiary proof that claimants need to file to corroborate their beneficial ownership.

A claimant must provide the SFTA with all information which could be relevant to the reclaim request and subsequent refund decision as well as furnishing the necessary documentation. The duty of cooperation does not only cover instances where the burden of proof falls upon the claimant but also where the burden of proof falls upon the SFTA and the latter requires additional information in order to satisfy such burden. Where a claimant does not comply (fully or

partially) with this duty of cooperation and where the SFTA cannot determine a claimant's eligibility for refund without the requested information and/or documentation, the SFTA shall deny the reclaim application. These general principles which are currently already in effect and have been widely accepted as the SFTA's practice would, should the Draft Law come into effect, find a legislative basis where reclaim requests are based on a double tax treaty.

The Draft Law would also determine the procedural steps to be taken by a claimant where such claimant is not in agreement with the SFTA's decision to fully or partially deny a reclaim request.

Additionally, and in accordance with applicable case law, the Draft Law would incorporate into the statute the applicable reclaim deadlines. Currently, these deadlines are the same as under applicable national law. Therefore, a reclaim application must be filed within three years following the end of the calendar year in which the taxable income was received. Additional time may be granted where the withholding tax in question was only remitted following an objection by the SFTA and certain other requirements are met.

Penal provisions

Where a non-Swiss resident unjustifiably effects a refund of Swiss withholding tax or a Swiss-resident third person effects an unjustifiable refund to the benefit of a non-Swiss resident, the reclaim leading to such refund is based on an international tax treaty between Switzerland and another jurisdiction. Therefore, Swiss national penal provisions as contained in the WHTA are not applicable to these actions.

The Draft Law introduces penalties for, inter alia, the following:

- ▶ *Withholding tax evasion*: A non-Swiss resident willfully or negligently effecting a wholly or partially unjustifiable refund of Swiss withholding tax or a Swiss-resident third person willfully or negligently effecting such wholly or partially unjustifiable refund to the benefit of a non-Swiss resident. The fine for such act would be the higher of: (i) up to CHF30,000 or (ii) thrice the amount of the unjustifiable advantage.
- ▶ *Endangerment of Swiss withholding tax*: Where, willfully or negligently, (i) untrue information is furnished, substantial facts are hidden or false documentation pertaining to substantial facts is provided in connection with a reclaim application, (ii) the claimant or a third party with a reporting obligation furnish untrue information, or (iii) unjustifiable or already fulfilled reclaims are made.

In such cases, the SFTA would have recognized that the reclaim application led to an unjustifiable refund and would, therefore, have denied the reclaim. The fine for such acts would be an amount of up to CHF20,000.

Where an act as described above is committed maliciously, additional and/or higher penalties may occur pursuant to the Swiss Administrative Penal Code (*Bundesgesetz über das Verwaltungsstrafrecht, VStrR*).

Additionally, as mentioned previously, the Draft Law would introduce penalties pertaining to the endangerment of Swiss individual and corporate income taxes as well as violations regarding the crediting of foreign residual taxes in Switzerland. As these penalties relate to Swiss-resident persons, they have been excluded from further discussion in this Alert.

Impact

The Draft Law's proposed procedural provisions reflect current SFTA and Swiss Federal Supreme Court practice. Their introduction would, therefore, not lead to any significant changes compared to the processes currently in place for non-Swiss resident claimants.

As detailed above, currently, a claimant must provide the SFTA with all information which could be relevant to the reclaim request and subsequent refund decision as well as furnishing the necessary documentation, including in cases where the burden of proof falls upon the SFTA. The enactment of such provision would lead to a legal basis for the trend observed in the SFTA's handling of reclaim applications by non-Swiss resident claimants over the past years, whereby the amount of information and documentation to be provided as well as the corresponding granularity have steadily increased. If the Draft Law is enacted, it can be expected that these procedural provisions are unlikely to reduce the average amount of time for the processing and granting of such reclaim applications.

In contrast to the procedural provisions, the penal provisions to be introduced by the Draft Law do not reflect the current practice environment. Currently, both withholding tax evasion and the endangerment of Swiss withholding tax are national offenses only where the element of maliciousness is missing, i.e., the national provisions providing for penalties on such offenses cannot currently be applied to non-Swiss resident claimants where maliciousness cannot be proven.

In general, it has been observed that the SFTA will not grant a refund where there are (serious and legitimate) doubts about the identity of the beneficial owner of the income, the entitlement of the claiming party to file for and receive a refund or the accuracy of the supporting documentation provided. Where the SFTA has determined that the level of comfort is not sufficiently high, the claimant will typically be asked to provide additional information and documentation in order to come to a decision whether a refund will be granted. Currently, where behavior qualifying as endangerment of Swiss withholding tax by a non-Swiss resident claimant is identified, the SFTA may only deny a reclaim application. In such circumstances, no fine may be levied against the non-Swiss resident. The same holds true for withholding tax evasion by a non-Swiss resident claimant, provided the element of maliciousness cannot be proven.

It is not expected that the introduction of these new penal provisions will lead the SFTA to examine reclaim applications less rigorously or request less additional information and documentation. However, non-Swiss resident claimants as

well as Swiss-resident third persons acting to their benefit and third parties with reporting obligations should be aware that penalties may also be levied where the offenses described previously are committed negligently. Consequently, the content and accuracy of information and documentation provided to the SFTA will gain importance once the Draft Law is enacted.

It is currently unknown, how - provided the Draft Law is enacted - the SFTA's practice in terms of determining the amount of potential fines to be levied will develop as no clear guidelines thereon have been published as of yet.

Current status

The public consultation process for the Draft Law was initiated in December 2019 and was set to end on 27 March 2020, with enactment of the Draft Law estimated to be mid-2021. Due to the ongoing COVID-19 crisis, it is currently unclear when the legislative process pertaining to the Draft Law will continue and at which point it may be enacted.

Endnotes

1. Cf. 1962 Ordinance on Measures to Prevent the Unjustified Use of Swiss Double Tax Treaties, *Verordnung des Bundesrates vom 14. Dezember 1962 über Massnahmen gegen die ungerechtfertigte Inanspruchnahme von Doppelbesteuerungsabkommen des Bundes, BRB62*; cf. Ordinance on the Tax Relief on Swiss Dividends from Qualifying Participations of Foreign Entities, *Verordnung des Bundesrates vom 22. Dezember 2004 über die Steuerentlastung schweizerischer Dividenden aus wesentlichen Beteiligungen ausländischer Gesellschaften*.
2. Cf. Ordinance on the Credit for Foreign Withholding Taxes, *Verordnung des Bundesrates vom 22. August 1967 über die Anrechnung ausländischer Quellensteuern, VO pStA*; cf. Ordinance No. 1 of the Federal Finance Department on the Credit of Foreign Withholding Taxes, *Verordnung 1 des EFD vom 6. Dezember 1967 über die Anrechnung ausländischer Quellensteuern, VO pStA 1*; Ordinance No. 2 of the Federal Finance Department on the Credit of Foreign Withholding Taxes, *Verordnung 2 des EFD vom 12. Februar 1973 über die Anrechnung ausländischer Quellensteuern, VO pStA 2*.
3. Organisation for Economic Co-operation and Development.
4. Base Erosion and Profit Shifting.

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