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Global Tax Alert

Zambia-Switzerland new tax treaty enters into force

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Executive summary

The new tax treaty between Zambia and Switzerland, (the 2017 Treaty or the Treaty), signed on 29 August 2017, entered into force on 7 June 2019. The provisions of the 2017 Treaty will become effective as from 1 January 2020. The Treaty will supersede the earlier agreement that had been signed by the United Kingdom and Switzerland prior to Zambia's independence in 1954 (the 1954 Treaty). The 1954 Treaty was extended to Zambia in 1961.

The 2017 Treaty is largely based on the Organisation for Economic Co-operation and Development (OECD) Model Tax Treaty. The new treaty reduces some of the treaty benefits (0% rates) that were provided under the 1954 Treaty.

This Alert summarizes key provisions of the 2017 Treaty.

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Detailed discussion

Tax rates

The applicable treaty rates under the new agreement are as follows:

	2017 Treaty	1954 Treaty
Dividends	15%/5%/0%	0%
Interest	10%	0%
Royalties	5%	0%
Management fees	0%	0%

The Treaty provides for a rate of 15% on dividends, which is lower than the normal rate of 20% that came into effect on 1 January 2019. The reduced rate of 5% on dividends is only applicable if the beneficial owner is a company (other than a partnership) that directly owns at least 10% of the capital of the company paying the dividends for a period of 365 days (including) the day of the dividend payment. For computing the qualifying period, changes of ownership resulting from mergers and demergers will be ignored. A reduced rate of 0% will apply if the beneficial owner is a pension fund, national bank or local authority of the Contracting State.

Permanent establishment

There are notable differences between the permanent establishment (PE) provisions of the Treaty and those of the OECD Model.

The 2017 Treaty provides that a building site, a construction, assembly or installation project or any supervisory activity in connection with such site, project or activity will give rise to a PE if it continues for a period exceeding 183 days. In contrast, the OECD Model provides for a period of more than 12 months.

The Treaty now also provides for a service PE that was not included in the 1954 Treaty. The service PE will be deemed to exist when the services are provided in a Contracting State for an aggregate period of 183 days or more within a 12-month period. This is a departure from the OECD Model Treaty which provides for a twelve-month service PE threshold. This is also a notable difference from the provisions of the *Zambian Income Tax Act* which has the threshold of 90 days.

According to the Treaty, an independent agent will not be considered to be independent when its activities are devoted wholly or almost wholly to one foreign enterprise and the transactions between the agent and the foreign enterprise are not at arm's length.

Business profits

Similar to the 1954 Treaty, the 2017 Treaty provides that business profits of an enterprise in one Contracting State shall be taxable in that Contracting State unless it operates through a PE in the other Contracting State, in which case only business profits attributable to such a PE would be taxed in the second Contracting State.

The 2017 Treaty also requires that profits to be attributed to the PE be determined by the same method each year unless there is good and sufficient reason to the contrary.

The Contracting States are precluded from adjusting the profits attributable to a PE of an enterprise of a Contracting State after five years from the end of the fiscal year in which the profits would have been attributable to the PE. The restriction does not apply in the case of fraud, gross negligence or willful default.

Capital gains

The Treaty provides that capital gains derived by a resident of a Contracting State from the disposal of shares of a company of which more than 50% of the value is derived directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State. This does not apply to shares that are listed and traded on a stock exchange. Furthermore, shares that derive more than 50% of their value from the immovable property in which the company undertakes its operations will also be excluded.

Exchange of information

The 2017 Treaty limits the Contracting State's ability to provide information which is not obtainable under the laws or in the normal course of the administration of the other Contracting State. It is not clear how this will apply in practice given the different information privacy provisions of the Contracting States. It is worth noting that this limitation does not allow a Contracting State to refuse to disclose information solely because it is held by a bank, other financial institution, an agent or a person acting as agent or trustee or because the requested information relates to a person's property rights.

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