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Repatriation of Swiss source dividends to EU corporate shareholders free of withholding tax



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On July 1, 2005, the Swiss-EU Agreement providing for measures equivalent to those laid down in the Council Directive of 2003 on taxation of savings income in the form of interest payments (the "Agreement") entered into force. Corporate groups in both Switzerland and the EU can now benefit from measures equivalent to those laid down in the EC Parent-Subsidiary Directive of 1990 and the EC Interest and Royalty Payments Directive of 2003.

Introduction

As in the EC Parent-Subsidiary Directive of 1990, under the Agreement, cross-border dividend payments by subsidiary companies to parent companies are not subject to taxation in the source country if the following criteria are met:

- the parent company has had a direct minimum holding of 25% of the capital of the relevant subsidiary for at least two years;
- one company is resident for tax purposes in an EU member state and the other company is resident for tax purposes in Switzerland;
- both companies are subject to corporation tax without being exempted;
- both companies have adopted the form of a limited company (as described below); and
- under any double tax agreement with a third country, neither company is resident for tax purposes in that third country.

Scope of Application

The Agreement applies to all EU member states, including the member states joining the EU on May 1, 2004 such as Malta and Cyprus. It also is applicable to Guadeloupe, Guyana, Martinique, Reunion (France), Gibraltar (Great Britain), Madeira, Azores (Portugal) and the Canary Islands (Spain). It does not, however, apply to the Channel Islands (Guernsey, Jersey and the Isle of Man). The Agreement will be extended to other territories that join the EU in the future. Temporary provisions apply to Spain and Estonia.

Guidelines Issued by the SFTA

The Swiss Federal Tax Administration ("SFTA") issued guidelines on July 15, 2005 for the application of the Agreement's provisions concerning intra-group dividend payments (the "Guidelines").

The term "dividends" is interpreted in the Guidelines the same manner as in the OECD Model Convention on Income and Capital (the "OECD Model Convention") as well as in the bilateral double taxation treaties entered into by Switzerland. The term includes constructive dividends as well as liquidation dividends. The Agreement also is applicable to dividends paid from retained earnings accumulated by a Swiss company or a capital surplus contributed to a Swiss company prior to July 1, 2005 (so-called "old reserves"). It also applies if the ownership of a Swiss company has previously changed from one EU member state to another and such old reserves were previously subject to non-refundable Swiss withholding tax at the previous treaty rate.

As noted above, the parent company must have had a direct, minimum holding of 25% of the capital of the relevant subsidiary company for at least two years. According to the Guidelines, the direct holding requirement is met even if a fiscally transparent partnership has been interposed in the ownership structure between the subsidiary and the parent company. The Guidelines state that the two-year holding requirement under the Agreement can be fulfilled retrospectively. If at the time the dividend was paid the two-year holding period has not yet been fulfilled, the Swiss company is still required to pay the amount of Swiss withholding tax that normally would have been levied in the absence of the Agreement – either at the domestic rate of 35% or the relevant double-taxation treaty rate. After the lapse of the two-year period, the withholding tax so paid will be reimbursed upon request.

The parent and the subsidiary company must be subject to corporation tax without being exempted. A company is exempt if it is not subject to corporation tax at all or if it is fully or almost fully exempt based on an economic development incentive in the

form of a "tax holiday". From a Swiss point of view, companies taking advantage of relief for qualifying dividends, holding and auxiliary companies are not considered to be exempt from corporation tax.

The parent and the subsidiary company must have adopted the form of a limited company. The possible acceptable forms of corporate entities are specifically listed in the Agreement, and include the corporation (*Aktiengesellschaft*), the limited liability company (*Gesellschaft mit beschränkter Haftung – GmbH*) and the partnership limited by shares (*Kommanditaktiengesellschaft*). The Agreement does not contain an equivalent list of qualifying EU business organisations, but such a list is provided in the annex to the EC Parent-Subsidiary Directive.

The term "residence" is to be interpreted as in the OECD Model Convention as well as in the bilateral double taxation treaties entered into by Switzerland. Therefore, if double taxation arises, the residence of a company is deemed to be the country where its place of effective management is located. The requirement that, under any applicable double taxation agreement with a third country, neither the parent company nor the subsidiary may be a tax resident of that third country, ensures a consistent interpretation of the term "resident" with respect to the Swiss-EU Agreement and double taxation agreements with third countries.

Interaction between the Agreement and the applicable double taxation treaty

The existing double tax treaties between Switzerland and EU member states remain applicable. This means that the taxpayer can choose to apply the more favourable treaty. Nevertheless, it has to be borne in mind that double taxation treaties which are more specific or which enter into force later than the Agreement have priority.

Anti-Abuse Regulations

The Agreement applies without limiting the application of domestic or treaty-based provisions for the prevention of fraud or abuse in Switzerland and in EU member states. This clause only refers to existing provisions and is not an autonomous, anti-abuse clause. As far as Swiss law is concerned, this clause refers to tax fraud, the fraudulent reduction of withholding taxes and abusive assertion of legal right (*Rechtsmissbrauch*) in general.

Procedure

Relief under the Agreement from withholding taxes at the source is granted by the SFTA upon request

(Form 823C) and will last for a period of three years. If the two-year holding period has not yet been fulfilled, the relevant Swiss company is required to pay the amount of Swiss withholding tax that normally would have been levied in the absence of the Agreement. Once the two-year holding period has expired, this amount will be reimbursed following the submission of the new Form 70.

Consequences

The relief from withholding tax on dividends in accordance with the EU Parent-Subsidiary Directive as interpreted by the SFTA (for Swiss outbound dividends) will strengthen the position of Switzerland as a location for holding companies and stimulate investment activity in Switzerland. It is especially important for dividend payments made to or from Malta or Cyprus because there is no double taxation treaty between Switzerland and these countries. It is yet to be seen how the individual EU member states will apply the Agreement, which will have a significant influence on withholding tax exemptions for both EU-source and Swiss-source dividends, because source- and recipient-country rules have to be considered. With regard to existing structures, the tax-free repayment of reserves, despite prior intra-EU changes in ownership, offers a wide range of planning opportunities and will, in many cases, be a good reason to reconsider repatriation and distributions policies. Unfortunately the Guidelines do not provide rules for withholding tax exemptions on intra-group interest payments. Such exemptions could open new planning opportunities for financing and cash pooling structures involving Switzerland.

The ww&p NewsLetter provides comments on new developments and significant issues of Swiss law. These comments are not intended to provide legal advice. Before taking action or relying on the comments and the information given, addressees of this NewsLetter should seek specific advice on the matters which concern them.

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