

Tribunal Sides With Taxpayer in Beneficial Ownership Case

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In what appears to be the first reported court case worldwide dealing with beneficial ownership as it applies to total return swaps (TRSs) in a tax treaty context, the Swiss Federal Administrative Tribunal has handed down a judgment¹ in favor of the taxpayer.

Under a TRS, the long party promises to pay to the counterparty the amount of appreciation of the share price of a given equity or basket of equities and an amount corresponding to the dividend distributed, while the counterparty undertakes to pay the amount of depreciation of the share price and a margin. By entering into a TRS, a party can indirectly benefit from the development and yield of a Swiss equity without incurring the Swiss withholding tax of 35 percent (or as reduced by treaty) that is levied in cases of direct investment.

In the case now decided, a Danish bank, with counterparties in the European Union and the United States, in 2007 entered into several TRSs involving Swiss equities. As a hedge in the transaction, it acquired the corresponding amount of the underlying Swiss shares.

A dividend was paid on the shares, and the Swiss withholding tax of 35 percent was levied. The Danish bank (shareholder) asked for a refund under the Denmark-Switzerland income tax treaty of 1974,

¹A-6537/2010 of Mar. 7, 2012, was not yet published on the Internet as of March 15, 2012.

which at that time provided for a full refund of the withholding tax. (The treaty has since been amended and now provides for a final withholding tax of 15 percent.)

The Swiss Federal Tax Administration denied the refund, arguing that because it entered into the TRS transactions, the bank lost beneficial ownership of the shares and committed treaty abuse. The tax authority also called for the repayment of the withholding tax refund granted the previous year, plus interest.

In response to a complaint by the bank, the Swiss Federal Administrative Tribunal granted the refund, finding that the bank retained beneficial ownership. Further, because the bank has offices, personnel, and a wide commercial activity, there was no treaty abuse, the tribunal said. It held that the obligation to pay the amount of the dividend to the counterparty under the TRS was not conditional on the bank's receipt of the dividend. The amount would have had to be paid even if, for whatever reason (for example, embargo, setoff, or attachment), the dividend could not have been collected, or if the TRS had not been hedged at all by acquisition of the underlying shares.

The Swiss tax authority has until April 12 to appeal the case to the Swiss Federal Supreme Court.

Beneficial ownership is a highly controversial issue in international tax, particularly since the OECD issued its discussion draft on the issue in April 2011. Hence, the Swiss case is likely to attract worldwide attention and may also influence the work of the OECD in this area. ◆

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