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Swiss Tribunal Rules on Ownership And Treaty Abuse Issues Regarding Total Return Swaps

by Marcus Desax and Martin Busenhart

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PRACTITIONERS' CORNER

Swiss Tribunal Rules on Ownership and Treaty Abuse Issues Regarding Total Return Swaps

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The authors represented the petitioner for refund and subsequent complainant.

On March 7 the Swiss Federal Administrative Tribunal, to the extent ascertainable, handed down the first reported judgment[1] worldwide on the issues of ownership and treaty abuse in connection with fully hedged total return swaps (TRS). A Danish bank had entered into a TRS for Swiss equities. To hedge its exposure, the bank acquired the necessary amount of Swiss underlyings. On the dividend declared, the Swiss withholding tax was withheld. The Swiss Federal Tax Administration (SFTA) refused the refund of the withholding tax under the Denmark-Switzerland tax treaty,[2] arguing that the bank did not have beneficial ownership and had engaged in treaty abuse. The tribunal reversed the decision and granted the refund.

TRS and Its Hedge

Under a TRS, the long party (in the case at hand, the bank) promises to pay to the counterparty, or short party, the amount of appreciation 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 and a margin.

The investment in a TRS allows the short party to benefit from the return of a given equity by using leverage and without incurring stock exchanges dues and without being subject to disclosure requirements. Unlike dividends, payments under a TRS are not subject to the Swiss dividend withholding tax. There is, however, the counterparty risk for both the long and short party.

The long party may hedge its exposure under the TRS by acquiring the necessary amount of underlyings. The bank was fully hedged.

The Tax Treaty Context

The case arose under the 1973 Denmark-Switzerland tax treaty. Its relevant provisions differed from the OECD model treaty in its 1963 version then in effect and had the following content (translation):

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[1]The official citation is ''Judgment of the Swiss Federal Administrative Tribunal A-6537/2010 of 7 March 2012.'' As there are other swap cases pending before the tribunal and it is likely that the Swiss Federal Tax Administration will appeal the judgment to the Supreme Court, it is suggested that the judgment be cited as *Swiss Swaps I/A*. The Supreme Court case in this matter will then be cited as *Swiss Swaps I/B*. Subsequent tribunal decisions on swaps will be cited as *Swiss Swaps II/A*.

The paragraphs of the judgment are not numbered. The findings of facts are subdivided in paragraphs A through T. The holdings of law are subdivided in considerations 1 through 9.3.3.

The judgment is available (in German) at http://www.walderwyss.com/de/news-und-anlaesse/?action=newsdetail&id=63 and (in English) at http://www.walderwyss.com/en/news-and-events/?action=newsdetail&id=63.

[2]Double Taxation Convention Between the Swiss Confederation and the Kingdom of Denmark for the Avoidance of Double Taxation With Respect to Taxes on Income and Net Wealth of November 23, 1973.

Article 10 Dividends

Dividends paid by a company which is a resident of a Contracting State to a person resident of the other Contracting State may only be taxed in that other State.

Article 26 Refund procedure

1. If one of the Contracting States withholds taxes on dividends, interest or royalties (at source), the right to such withholding is not affected by this Convention.

2. To the extent that its levy is restricted by this Convention, tax withheld (at source) however is to be refunded upon request.[3]

Facts of the Case

The bank had been established in Denmark decades ago, and is engaged in the banking business. From 2006 through 2008, it entered into total return equity swaps with counterparties resident of the United States, Germany, France, and the United Kingdom regarding Swiss equities. To hedge its exposure under the TRS, the bank acquired the Swiss underlyings. They were resold after expiration of the TRS.

When the Swiss companies distributed dividends, a 35 percent dividend withholding tax was withheld and remitted to the SFTA. The withholding tax levied in 2006 was swiftly refunded on the basis of the certification on the official SFTA form, which stated that the bank is a resident of Denmark taxable on its worldwide income and that on the dividend due date, it was the beneficial owner of the respective shares.[4]

The 2007 and 2008 refund requests of the bank, however, met with opposition from the SFTA.

Arguments Filed With the SFTA

Comprehensive Demand for Information

The SFTA required comprehensive information from the bank on its dealing in Swiss equities, in particular whether the bank had engaged in swap, repurchasing, or securities lending transactions. If the bank had, the SFTA demanded, it must disclose all contracts and the identities and addresses of the counterparties.

The bank responded that it had entered into TRSs, and it provided redacted copies of the agreements. No TRS had a term of less than a month. The average was six months. Several TRSs covered a time when no dividend was paid. The counterparties in the TRSs were said to be corporate entities in the United States, Germany, France, and the United Kingdom. However, the bank refused to disclose the names and addresses of the counterparties, arguing that this would violate Danish banking law and expose the bank to criminal sanctions.

The shares acquired for hedging purposes were purchased through brokers whose names were disclosed. Upon termination of the swaps, the bank sold the shares to third parties that might or might not be the same as the brokers from which the shares had been purchased initially. In no case were the shares acquired from customers interested in the TRSs, nor were TRSs offered to brokers from which the shares were purchased. At the end of the TRSs, the shares were never sold to the counterparty with which the swaps was entered into. Moreover, there were no prearrangements with the brokers for the repurchase of the shares. Actually, the bank's internal policies prohibit share purchases from customers to whom the TRSs were offered.

There were no agreements with the TRS counterparties as to how the voting rights of the shares should be exercised.

Nontax Reasons for Entering Into a TRS

The bank argued that the counterparties did not derive a tax benefit by entering into the TRSs. Under the tax treaties between Switzerland and their countries of residence, had these companies invested directly in the Swiss equities, they would have been able to obtain a credit for the nonrefundable Swiss withholding tax against their corporate income tax liability.[5]

Hence, they paid exactly the same amount of profit tax they would have paid had they held a direct investor position or been a counterparty in a TRS.

There are many nontax reasons to enter into a TRS.[6]

Risks Retained by Long Party Under TRS

The following risks always remained with the bank:

- credit risk of the TRS counterparty;
- collection risk if the dividend declared did not reach the bank (for example, because of embargo, the dividend distributing company is also a creditor of the shareholder and sets off its claim against the shareholder against the obligation to pay the dividend, attachment by a creditor of the bank at the dividend paying company);

[3]The Denmark-Switzerland tax treaty has since been revised and now provides for the usual 15 percent withholding tax on portfolio investments in shares.

[4]In 2007 the SFTA form was changed and now requires the petitioner of the refund to state that it is the beneficial owner of the *dividend*.

[5]Article 23(2) of the Switzerland-U.S. tax treaty; article 24(4) of the Germany-Switzerland tax treaty; article 25A(1) of the France-Switzerland tax treaty; article 22(1)(a) of the Switzerland-U.K. tax treaty.

[6]The taxpayer cited Don M. Chance, ''Equity Swaps and Equity Investments,'' *Journal of Alternative Investments*, Summer 2007, Vol. 4, No. 1, pp. 75-97, *available at* http://www.iijournals.com/doi/abs/10.3905/jai.2004.419606.

- settlement risk that the shares purchased for, or sold to, the brokers may not be settled;
- financing risk that it may not be possible to finance the operations at a rate commensurate with the floating amount paid by the counterparty under the TRS; and
- liquidity risk that the bank may be unable to identify buyers to close out the hedge.

Dividend as Percentage of Share Price

The bank pointed out that under a TRS with a term of more than a month, any withholding tax savings by a counterparty residing in a treaty country that provides for a final 15 percent withholding tax would be insignificant when compared with the volatility of the share.

The table shows the 2006 and 2007 dividends of some of the Swiss equities that were used in the TRSs. It also lists the tax value of the respective share at the end of the year as officially published by the SFTA.[7] The listing shows that the dividend of these companies represented between 0.5 and 2.1 percent of the tax value of the share.

Dividend Paid as Percentage of Tax Value at Year End as Per SFTA List

Stock	Amount Dividend	Tax Value Stock	Dividend in Percent Tax Value
2006			
Novartis	1.15	70.25	1.60%
Nestlé	9.00	433.00	2.00%
ABB	0.12	21.85	0.50%
Roche	2.50	218.50	1.10%
2007			
Novartis	1.35	62.10	2.10%
Nestlé	10.40	520.00	2.00%
ABB	0.24	32.62	0.70%
Roche	3.40	195.60	1.70%

Low Residual Withholding Tax

To put the potential withholding tax savings into perspective, the highest amount of the dividend yield in the above sample is taken — that is, 2.1 percent (Novartis in 2007). By entering into a TRS, an investor resident of a country with an income tax treaty based on the OECD model treaty would obtain 2.1 percent rather than 1.79 percent (representing 85 percent, because 20 percent is refunded, thus leaving a residual tax of 15 percent). Hence, the ''savings'' of Swiss withholding tax that can be realized by an investor residing in a treaty country is 0.31 percentage point. Obviously, if the dividend yield is lower, the savings are smaller: An investor from a treaty country having bought 2006 a swap on ABB shares would have saved withholding tax of 0.17 percent of the share value (35 percent of 0.5 percent).

Share Price Volatility

Should an investor in a country where there is an income tax treaty with Switzerland enter into a TRS with a stock with a 2.1 percent yield (Novartis in 2007), the gain of enjoying the 0 percent rate under article 10 of the Denmark-Switzerland treaty as opposed to 15 percent for portfolio investments under the other treaties represents only 0.31 percent of the share price. If the yield is only 0.5 percent (ABB in 2006), the gain shrinks to 0.17 percent. Given that in a TRS the investor must pay the bank any negative difference between the share price at the beginning and at the end of the swap, any such difference in excess of 0.31 percent will wipe out all possible gain from the application of the 0 percent rate, rather than the 15 percent rate for portfolio investments.

Increases and decreases of the stock in excess of 0.3 percent, let alone 0.175 percent, occur daily, even in the absence of any significant event affecting the stock. If a longer period is considered, volatilities of 10 percent and more are not uncommon.

In the stocks mentioned above, the changes from the end of 2006 to the end of 2007 were the following (using SFTA year-end tax values):

- Novartis: -11.6 percent;
- Nestlé: +20 percent;
- ABB: +49 percent; and
- Roche: -10.5 percent.

Assuming that a TRS was entered into from January 1, 2007, to December 31, 2007, regarding these stocks — under which the bank would have to pay to the counterparty the dividend and the appreciation of the stock and the counterparty would have to pay to the bank the agreed on interest and the depreciation of the stock — the following amounts would have fallen due:

- Novartis: Payment by the counterparty to the bank of CHF 6.80 (62.10 - 70.25 + 1.35). Tax savings realized: CHF 0.20 (15 percent of 1.35). Without the withholding tax savings, the counterparty's loss would have been 2.9 percent higher.
- Nestlé: Payment by the bank to the counterparty of CHF 97.40 (520.00 - 433.00 + 10.40). Tax savings realized: CHF 1.56 (15 percent of 10.40).

[7]The share value at the end of the year as officially published in the SFTA's share listing, rather than the actual price on the dividend due date, was taken to allow easy verification of the amounts by the SFTA.

Without the tax savings, the counterparty's gain would have been 1.6 percent lower.

- ABB: Payment by the bank to the counterparty of CHF 11.01 (32.62 - 21.85 + 0.24). Tax savings realized: CHF 0.04 (15 percent of 0.24). Without the tax savings, the counterparty's gain would have been 0.4 percent lower.
- Roche: Payment by the counterparty to the bank of CHF 19.50 (195.60 - 218.5 + 3.40). Tax savings realized: CHF 0.51 (15 percent of 3.40). Without the tax savings, the counterparty's loss would have been 2.6 percent higher.

This shows that the driver for gains or losses is the volatility of the share, not the amount of the dividend, let alone the withholding tax savings.

Conclusion

It is wrong to state that a TRS of a term of more than one month is entered into merely for tax reasons. These figures show that the SFTA contention that the TRSs were entered into "exclusively for tax reasons" is inaccurate: The tax savings that an investor in a treaty country can realize is insignificant when compared with the potential of an increase of the share price or the risk of a decrease. Hence, no reasonable investor will deem such savings worth the costs and the risks of a TRS of a term of more than one month.

SFTA's Adverse Decision

On July 29, 2010, the SFTA issued a decision denying the refund of the 2007 and 2008 withholding tax and requiring repayment of the 2006 refund with interest at the rate of 5 percent since the date of refund.

The SFTA stated that the transactions entered into by the bank were highly unusual and could be explained only by tax savings. By entering into the TRS, all risks were transferred from the bank to the counterparty. The full dividend was transferred to unknown counterparties. In the SFTA's view, the bank not only lacked beneficial ownership but also had engaged in treaty abuse. The requests for refund for 2007 and 2008 were denied and the bank was ordered to repay the refund for 2006 with interest at the rate of 5 percent per annum.

The SFTA indicated that its decision could be challenged by means of an opposition[8] to be filed with the SFTA.

Federal Administrative Tribunal

Bank's Complaint Against SFTA Decision

On September 13, 2010, the bank filed a complaint directly with the Federal Administrative Tribunal. It moved that the refunds be granted together with interest at 5 percent per annum since the date of the denying SFTA decision (July 29, 2010). It further petitioned that the decision requiring repayment of the 2006 refund be set aside.

Together with the complaint, the Danish bank supplied a deed of a Swiss notary public. The notary stated that he had been given access to all contractual documents of the TRS and the purchases and sales slips of the share trades.[9] He confirmed the following:

- the swap transactions were entered into with companies in the United States, Germany, France, and the United Kingdom; and
- the TRSs were not entered into with the companies that the bank disclosed as the sellers/purchasers of the shares acquired for hedging purposes.

Proper Legal Remedy

With its January 11, 2011, interim judgment on jurisdiction, the tribunal decided that unlike denials of refunds of the withholding tax addressed to domestic petitioners, denials of refunds under an income tax treaty are not subject to the remedy of opposition but are subject to complaint to the tribunal.[10]

Because the SFTA did not appeal the interim judgment to the Federal Supreme Court, the interim judgment on jurisdiction became final, allowing the tribunal to resume the procedure.

Pleadings Regarding Substance

In its answer to the complaint, the SFTA addressed only the procedural issue of the functional jurisdiction of the tribunal, not the substantive issues. Referring to the principle of Swiss civil procedure law in which a defendant who, without permission of the court, has limited the answer to the statement to the plea of lack of jurisdiction, is estopped from filing further submissions, the bank moved that the SFTA not be allowed to argue the case as to the substance.

Dismissing this procedural motion, the tribunal allowed the SFTA to file a submission as to the substance, whereupon the bank filed a formal protest.[11]

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[8]The opposition (in German: *Einsprache*; in French: *réclamation*) is the usual remedy in Swiss domestic tax law. The opposition is filed with the deciding tax authority, which then reviews its decision in light of the factual and legal arguments contained in the opposition. The SFTA's handling of oppositions in cases of refunds of the withholding tax under tax treaties takes some 12 to 18 months. If the opposition is denied, then the remedy of complaint to the Federal Administrative Tribunal is available. As no interest is paid on the refund, this long duration is to the detriment of the petitioner of the refund.

[9]The disclosure of the customer documents by the bank to the Swiss notary public did not amount to a violation of banking secrecy. The notary is also an attorney and a partner of the legal representatives of the bank.

[10]*See Tax Notes Int'l*, Feb. 14, 2011, p. 493, *Doc 2011-2667*, or *2011 WTD 26-4*.

[11]This formal protest is recorded in consideration O of the judgment, and consideration R mentions that SFTA's handling

(Footnote continued on next page.)

On March 7, 2012, the tribunal rendered its judgment and notified it to the parties on March 13.

March 7 Judgment

Duration of Proceedings

The tribunal noted that the refund procedure had lasted three years (2007 refund) and two years (2008 refund). Noting that this duration ''no longer appears to be short,'' it still qualified it as not excessive (considerations 1.3 and 8.3). It did not characterize the SFTA's attitude in the proceeding before the tribunal as dawdling: ''The SFTA has the right in an exchange of legal submissions (or, as in this case, more than one exchange) to take new points in law and in fact and to submit fresh evidence'' (consideration 8.4).

No Obligation to Disclose Counterparties

The SFTA charged the bank with not having discharged its obligation of cooperation by not disclosing the names and addresses of the counterparties. The tribunal held (consideration 6.2.4[12]):

> The Complainant's duty to co-operate with the judicial authorities is limited to necessary, conscionable co-operation. In particular the Complainant cannot reasonably be expected to co-operate to the extent of rendering itself liable to criminal prosecution. The assertions of the Complainant on this point — that this would be the case if it were to disclose the identity of its banking clients — are plausible and reasonable. . . . In the light of the aforementioned notarized certificate the Federal Administrative Tribunal considers it proven that the swap counterparties were not the same as the buyers and sellers of the shares.

Nonapplication of Specific Antiabuse Provision

The Withholding Tax Act (WHTA), which deals with refunds in a domestic context, includes a specific provision denying the right to refund in the event that it would lead to tax evasion (article 21(2)[13]). The tribunal held that this general antiavoidance provision of domestic law cannot be applied to a refund under an income tax treaty. It stated (consideration 2.3):

> Whereas domestic entities may reclaim the withholding tax levied on income generated by moveable capital assets if they were the beneficial owner of those assets at the time the taxable payment fell due and if refunding the tax does not result in tax evasion (consideration 2.2), different conditions apply to foreign recipients. They are entitled to a refund only if a double taxation convention (DTC) concluded between Switzerland and their country of residence so provides. The reason for the difference in treatment is that, for foreign recipients, the withholding tax does not serve the purpose of providing security but rather a fiscal or debit purpose. It follows that, in international situations, Art. 21(2) WHTA (tax evasion reservation) has no (or no direct) application.
>
> For the reasons just mentioned, with foreign beneficiaries it is never a case of reimbursing the original withholding tax per se, but rather of quantitatively demarcating the powers of taxation of the two countries. Because Art. 21(2) WHTA applies to refunds of withholding tax to persons with seat in Switzerland (cf. above consideration 2.2), i.e. to reimbursement of the original withholding tax per se, the (direct) invocation of this tax evasion clause to deny a refund entitlement provided for in a DTC is excluded. In addition, because the DTC forms part of international law, in principle it takes precedence over the WHTA.

Beneficial Ownership

After noting that article 10(1) of the Denmark-Switzerland tax treaty does not expressly mention beneficial ownership as a condition to the treaty benefit (consideration 3.3.1), the tribunal stated (consideration 3.3.2):

> The legal writers'[14] overriding majority view is that the criterion of beneficial ownership is implicit in every DTC. This view is largely based on the OECD-MC and its commentaries, the claim being made that the relevant passages in the commentary have merely been supplemented in order to clarify this point, which itself corresponds to the view consistently taken by all OECD member states. There is a dispute amongst the legal writers[15] on the extent to which reference to elements of the OECD-MC or the associated passages in the commentaries that post-date the pertinent DTC text may legitimately be made in order to interpret that pre-existing specific DTC text. As will be shown below (considerations 3.4 and 6), in the instant case there is no need to answer the question of whether the criterion of beneficial ownership is also present in the

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of the procedure is said by the bank to have been ''dawdling.'' However, the judgment does not state the fact that the SFTA, on its own initiative and without permission of the tribunal, limited its answer to the complaint to the issue of functional jurisdiction of the tribunal, thereby causing further submissions and a loss of time detrimental to the bank.

[12]In the following quotes, the references to court decisions and legal writers are omitted.

[13]Article 21(2) of the WHTA reads as follows (translation): ''The refund is inadmissible in all cases in which it would lead to tax evasion.''

[14]Although the tribunal does not say it explicitly, its citation indicates that the legal writers are meant to be Swiss, not international.

[15]This time, non-Swiss writers are also cited.

> [Denmark-Switzerland tax treaty] despite not being explicitly mentioned there, just as there is no need to answer the question as to which of the conflicting views on this matter the Tribunal wishes to side with. Thus there is no need for the Tribunal to address the Complainant's assertions on these issues and in particular on the latest OECD ''Discussion Draft'' on beneficial ownership published on 29 April 2011.

The tribunal pointed out that beneficial ownership serves to determine the intensity of the relationship between a taxpayer and the taxable object viewed from an economic point of view (consideration 3.4.1). Addressing more specifically the TRS, it held (consideration 3.4.2):

> If one person is obliged to pass on income to another, this shows that the first person's power to decide on the use of that income is limited. If the obligation to pass on income is contractual, this can militate against the qualification as beneficial owner. Further, a de facto duty to pass on income may limit the power to decide on the use of that income to such a degree that the person concerned can no longer be considered the beneficial owner. The stronger the mutual or reciprocal dependence or interdependence between the income and the duty or pass it on, the weaker the power to decide on its use. The key issue is the degree to which generating income is dependent on the obligation to pass it on. Besides that, the degree to which the obligation to pass on income is dependent on the generation of that income is to be considered. Moreover, a possible indication of beneficial ownership is the assumption of the risks associated with the income. Relevant in this in this context is particularly who bears the risk that no dividend is paid. In terms of the timing, an assessment of beneficial ownership is to be made at the time at which the income was paid. Therefore the fact of a very brief holding period does not preclude beneficial ownership. Furthermore, the concept of beneficial ownership disregards subjective factors, such as any intention of abuse. Thus the reasons for choosing a particular structure are immaterial to the question of beneficial ownership.

Dealing with the facts of the case at hand, after finding that the Danish bank was not legally obligated to pass on the dividend to the counterparty, it stated (considerations 6.2.1 and 6.2.2):

> The Tribunal must therefore consider whether there was a de facto obligation to pass on the dividends. Such an obligation is one way to limit the decision-making power to an extent that the person concerned can no longer be considered to be the beneficial owner. To this extent, therefore, the SFTA is right to assume that an approach based on ''substance over form''[16] (cf. consideration 3.4.1) or economic considerations is authoritative. To answer the question as to whether there was a de facto obligation to pass on the dividends, it must first be ascertained whether the Complainant would have been obliged to pay the dividend amount to the counterparty even if on its part it had not received the dividends. Secondly, the Tribunal must examine whether the Complainant would have received the dividends even if it had not been obliged to pay the dividend amount to the counterparty. In the present case the answer to both questions is in the affirmative. Regardless of whether it received the dividends, the Complainant was obliged to pay the counterparty the amounts equivalent to the dividends. At the same time, the Complainant was free to decide, independently of the swap contracts, whether to buy the shares in question and to receive the corresponding dividends. The lack of interdependence (cf. consideration 3.4.2) shows that the Complainant did indeed have the power to decide how to use the dividends it received. The Complainant therefore was under no de facto obligation to pass on the dividends. It was free to dispose of them as it wished and to use them for other purposes instead.
>
> The SFTA's contention that the Complainant cannot be considered to be the beneficial owner because the dividend amount did not remain in its possession does not hold water according to the view taken by the Federal Administrative Tribunal. When evaluating the power to decide how the dividends paid out are used it is wrong to take a purely ex post facto perspective focusing on whether the dividends remained with the Complainant in economic terms. In terms of the timing, the determination of beneficial ownership must be based on the time at which the income was paid, i.e. in this case the point at which the dividends were distributed (consideration 3.4.2). The Complainant's power to determine usage is to be assessed with regard to that point in time by examining the degree of interdependence between the transactions.
>
> The Federal Administrative Tribunal is well aware that in the case of the (hedged) swap contracts described it was not the Complainant but ultimately the counterparty who bore the risk that the companies might pay no dividends. Although this might be seen as militating against the Complainant's qualification as beneficial owner (cf. consideration 3.4.2), however, because the underlyings were purchased at the sole discretion of the Complainant for the purpose of hedging its

[16]In English in the judgment.

> obligations under the swap contract, in this case the assumption by the counterparty of the risks associated with the revenue streams does not preclude qualifying the Complainant as the beneficial owner of the dividend payments.

For the tribunal, the term of the TRS has no bearing on the qualification of the beneficial ownership (consideration 6.2.3).

The tribunal concluded (consideration 6.3):

> In conclusion it may be stated that, even if the requirement of beneficial ownership were deemed to exist in the [Denmark-Switzerland tax treaty] despite there being no explicit mention of it there (consideration 3.3.2), the Complainant would qualify as the beneficial owner of the dividends received.

Treaty Abuse

Regarding tax treaty abuse, the tribunal's holding of law is scant (considerations 4.1, 4.3, and 4.3):

> There is no international consensus on what constitutes abuse of a DTC. In Swiss legal literature — based on Federal Supreme Court practice according to which abuse of law (including at the international level) is found to exist when a legal institute is used contrary to its purpose to further interests that the legal institute does not intend to protect — the view is taken that, although claiming treaty benefits for purposes alien to the aims of the Convention can be described as an abuse of law, the same is not necessarily true with respect of all the other frowned upon forms of conduct described in the Convention with a view to preventing undesirable recourse to a DTC (known as ''abuse provisions of treaty law'').
>
> The issue hotly debated in the literature[17] of whether conventions contain an unwritten reservation of abuse has been settled by the Federal Supreme Court by way of interpretation. According to Federal Supreme Court practice, a DTC must be interpreted in accordance with Art. 31 et seq. VCLT and hence in the light of the principle of good faith (judgment of the Federal Supreme Court 2A.416/2005 of April 4, 2006, consideration 3.1).[18] Thus every contracting state may expect the other to interpret the convention in good faith and in accordance with its objectives, which excludes abuse of law, i.e. use legal institute for purposes that such institute does not intend to protect (judgment of the Federal Supreme Court 2A.416/2005 of April 4, 2006, consideration 3.1). The prohibition of abuse of law is therefore to be regarded as subsumed in the good faith principle and hence to be taken into account in any application of international conventions.
>
> If a convention does not contain an explicit abuse clause, under the practice of the Federal Supreme Court abuse of law can only be found to exist if the company concerned (in the instant case, the dividend recipient) does not carry on a genuine economic resp. commercial. To engage in such activity requires premises, personnel and equipment, the extent of the necessary infrastructure being dependent on the services rendered.

As the Danish bank carries on a banking business from its own premises with many employees (consideration 7.1), the tribunal found that it carries out a genuine economic activity and that therefore, the issue of tax treaty abuse does not arise:

> Accordingly, the Complainant engages in genuine commercial activity. Consequently, according to Federal Supreme Court practice there can be no treaty abuse. Further investigations into this aspect are thus superfluous.

Obligation to Repay 2006 Refund

Because the tribunal found that beneficial ownership and the issue of treaty abuse did not arise, ordering the SFTA to repay the 2006 refund with interest lacks foundation. It is therefore not necessary to examine the bank's arguments that under the Denmark-Switzerland tax treaty and Swiss domestic law, there is no basis for ordering the repayment of a refund granted (consideration 8.1).

Interest

The tribunal found that the SFTA was not in arrears of payment, as only a final decision granting the refund issued by the tribunal or the Supreme Court causes the payment obligation. Compensatory interest requires an express legal provision that does not exist (consideration 8.2). It stated in consideration 8.3:

> The Complainant is quite right to assert that, where proceedings regarding the refund of withholding tax are protracted, the fact that no interest is payable on the refund amounts is to the economic detriment of the taxpayer. Contrary to the Complainant's view, however, such detriment cannot result in the payment of compensatory interest where there is no legal basis for such interest.

Further Procedure

Against this judgment, two appeals have been launched with the Supreme Court.

In its appeal, the SFTA challenges the lower instance's findings of law regarding beneficial ownership

[17]Swiss and international authors are cited.

[18]This is the Denmark case of the Swiss Supreme Court *A Holding ApS v. Swiss Federal Tax Administration*, 8 ITLR 536.

and treaty abuse.[19] In its view, it is not the shareholder that enjoys beneficial ownership but rather the counterparty in the swap, respectively the last party in the chain if the swap was passed on to other counterparties. In the SFTA's view, TRSs are entered into only for tax reasons and therefore constitute tax treaty abuse. In addition, the SFTA maintains its claim that the refund made to the bank the previous year ought to be repaid with interest.

The Danish bank also filed an appeal. It claims that lower instance's judgment denying interest is discriminatory. It argued that, under an express provision of the Swiss Federal Income Tax Act that also governs the limited tax liability of nonresidents with respect to some items of income from Swiss sources (such as return of Swiss real estate, interest of claims secured by mortgage of Swiss real estate), the taxpayer is entitled to interest on excess taxes paid. The fact that the Swiss dividend withholding tax is not regulated in the Federal Income Tax Act but in the WHTA where there is not such a provision on interest does not justify a different treatment of nonresident recipients of Swiss dividends. This discrimination is claimed to violate the Swiss Constitution's equal protection clause and the nondiscrimination clause in the Denmark-Switzerland tax treaty. Among others, the Danish bank relied on a 1993 judgment of the European Court of Justice (*Commerzbank*), which precisely held that the grant of interest on excess taxes paid by a resident and the refusal of interest on excess taxes paid by a nonresident was discriminatory.

The judgment of the Swiss Supreme Court can be expected in the fall of 2012. ◆

[19]There is a notable difference between the tribunal's holding regarding beneficial ownership and the one on treaty abuse. The tribunal has left open the question whether beneficial ownership is also a requirement in income tax treaties that do not expressly mention it — that is, treaties entered into before 1977 when the OECD introduced the concept of beneficial owner in article 10 of the OECD model treaty — but still decided that the bank enjoyed beneficial ownership. In contrast, regarding treaty abuse, the tribunal applied the Supreme Court practice (that is, the holding in *A Holding ApS*) and did not decide whether, under the facts of the case, there was treaty abuse. This has a bearing on the scope of a possible appeal by the SFTA to the Supreme Court. Had the tribunal decided both issues — that is, the standard under the Supreme Court practice and the lack of actual misuse — the SFTA could have appealed to the Supreme Court and the Supreme Court could have decided only the factual issue of actual misuse and left open whether *A Holding ApS* should be reversed. With the tribunal's limitation to applying the Supreme Court standard of *A Holding ApS*, the SFTA can bring this matter to the Supreme Court and directly challenge the standard applied. The Supreme Court is then bound to review its earlier practice. It is also remarkable that the tribunal has not cited any of the extensive comments, Swiss and international, to *A Holding ApS* and has not expressed any opinion whether it considers *A Holding ApS* to be good law.