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Beneficial ownership – Is the tide turning?

On 3 October 2024, the Swiss Federal Supreme Court resolved a new lead case as to beneficial ownership in interest payments received by an International Financial Institution on Swiss bonds held. Beneficial ownership of the International Financial Institution was upheld although it had entered into a combined currency and interest rate swap arrangement with other International Financial Institutions. The entering into and the unwinding of the swap arrangement was lined up with the investment in and the residual term of the Swiss bonds held up to maturity.

As the International Financial Institution had to make payments under the swap arrangement even though it had not received any interest and principal payments from the Swiss bonds held, the Court ruled that the swap arrangement had no impact on the beneficial ownership of the International Financial Institution. Furthermore, the Court made it clear that the beneficial ownership concept on one hand and the question of abusive tax avoidance on the other hand were two independent issues subject to two separate tests to be applied, respectively.

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On 5 May 2015, the **Swiss Federal Supreme Court** rendered two landmark cases on dividend withholding tax refunds to International Financial Institutions holding Swiss equities (ref. 2C_364/2012, 2C_377/2012 and 2C_895/2012). We represented the claimant in one of these two cases. In both matters, among other points, the issue of **beneficial ownership** of International Financial Institutions in the dividends received from the underlying Swiss equities held in their equity pools was at stake. In order to establish whether the beneficial ownership requirement was met by the International Financial Institution, the Court applied a two-prong cumulative interdependency test. If the International Financial Institution (i) acquired the Swiss equities only to honour its obligations under a swap or another derivative arrangement entered into with a customer and (ii) if the International Financial Institution had to honour its obligation to pass on such dividends to its customer subject to the condition that it had effectively received the dividend on the underlying equities held (close link between the derivative and physical equity transactions), beneficial ownership of the International Financial Institution on the dividend received from the Swiss equities held was denied. However, quite some uncertainty remained as to the application of these principles.

On **16 December 2019** (ref. 2C_209/2017), the **Swiss Federal Supreme Court** reviewed a case where the borrower of Swiss equities in a securities lending and borrowing transaction was the recipient of the original dividend payment. With reference to the manufactured dividend that had to be contractually paid by the borrower to the lender, the Court concluded that the borrower was not the beneficial owner of the original dividend received. At least, this was clear guidance on beneficial ownership in securities lending and borrowing transactions.

On **19 May 2020** (ref. 2C_880/2018), the **Swiss Federal Supreme Court** had to decide again whether an International Financial Institution receiving dividends from Swiss equities held as a hedge under a Total Return Swap entered into with a customer could be viewed as beneficial owner of the dividend payments received. Again, the Swiss Federal Supreme Court ruled that this was not the case. However, in order to establish a lack of beneficial ownership, the Court focused on the second interdependency test (and disregarded the first interdependency test). Applying the second test, the Court noticed that, under the Total Return Swap agreement entered into by the International Financial Institution with its customer, there was a clause providing that the International Financial Institution only had to pay the net dividend amount received (after deduction of the 35% Swiss dividend withholding tax) from the Swiss equities held to its customer. Furthermore, an additional payment would be due if the International Financial Institution got a partial or full refund of the Swiss dividend withholding tax charged on the dividend received from the Swiss equities held. However, this second payment was reduced by a small fraction of the refund received as consideration to the International Financial Institution. At least, this provided quite some guidance on beneficial ownership in delta one transactions.

On **3 October 2024** (ref. 9C_635/2023), the **Swiss Federal Supreme Court** had to decide a case where an International Financial Institution had acquired Swiss government bonds and held them as safe investment up to maturity. By buying Swiss government bonds, the International Financial Institution entered into a currency (Swiss francs into US dollar) and interest rate (fix into floating interest rate) swap arrangement with other International Financial Institutions.

The entering into and unwinding of the combined exchange and interest rate swap was aligned with the investment in and the residual term of the Swiss government bonds held.

The Swiss Federal Tax Administration took the view that, by entering into such swap arrangements, the International Financial Institution had lost its beneficial ownership in the interest payments received from the Swiss government bonds held. The matter was brought to the Swiss Federal Supreme Court for final decision.

In its ruling, the Swiss Federal Supreme Court confirmed its Total Return Swap decision of 19 May 2020 and stated that the first interdependency test was meaningless. As to the second interdependency test, the Court clarified that beneficial ownership in the interest (dividend) payment received from the Swiss bonds held by the International Financial Institution would be lost if there were a legal (whether by law or as a contractual stipulation) obligation of the International Financial Institution to pass on the interest payment received to its swap counterparty, whereas the payment under the swap (derivative) transaction were contingent on the effective receipt of the interest payment from the Swiss bonds held. However, a mere factual "obligation" did not have such a detrimental effect on its beneficial ownership in the interest payment received from the Swiss bonds held.

In the case to be reviewed, the International Financial Institution was obliged to make its payment under the combined exchange and interest rate swap even though it had *not* received the respective interest or any other (principal) payment on its investment in the Swiss government bonds held.

For this reason, the Court ruled that the International Financial Institution was indeed the beneficial owner of the interest payments received from the Swiss bonds held and thus eligible for double tax treaty relief.

Finally, in this round at the Swiss Federal Supreme Court, the concept of **beneficial ownership** got quite some grip and we may say the Court got it right.

One may add that, in its most recent case, the Swiss Federal Supreme Court makes it clear that, in order to establish beneficial ownership in a payment received from Swiss bonds held, subjective elements such as the motive to realise a tax saving may be neglected. However, in extraordinary cases, such subjective motives may become relevant for tracking down abusive tax avoidance schemes (which would generally lead to a denial of the Swiss withholding tax refund sought by a refund claimant).

Accordingly, after a ten-year struggle with many instances involved, the Court confirmed that the beneficial ownership concept on one hand and the question of abusive tax avoidance on the other hand were two independent issues and that the corresponding tests had to be applied separately.