General Geelhoed's instruction to the source Member States to achieve, by means of a tax treaty, a relief for economic double taxation in the home Member State, which is equivalent to the relief in the source Member State.[33] The authors believe, however, that this does not mean that, if a source Member State does not levy economic double taxation in an internal situation, it is also responsible for avoiding economic double taxation on outbound dividends as such, but, rather, that the source Member State is responsible for removing *source Member State* double economic taxation, and that it does not matter whether this removal takes place in the source Member State itself or in the home Member State.

In the example, without the German withholding tax, economic double taxation would arise due to the home Member State's tax regime, and as such would constitute a disparity, or a quasi-restriction in Advocate General Geelhoed's line of reasoning, which falls outside the scope of the EC Treaty. In this case, in the authors' opinion, the German withholding tax that is fully creditable in the parent's residence Member State, despite its differential treatment, does not breach the freedom of establishment or the free movement of capital.[34] This is true, in the authors' view, irrespective of whether the German withholding tax is credited against the parent's corporate income tax liability in its residence Member State on the basis of its domestic tax legislation or a tax treaty. In other words, the authors believe that, if Advocate General Geelhoed's criteria are followed by the ECJ, these should be extended to include also the effect of the domestic tax legislation in the parent's home Member State.

A final question is whether or not Germany, if it provides a refund of domestic withholding tax on dividend income, should also provide a refund for foreign withholding tax on dividends derived from a foreign subsidiary. In the authors' opinion, no clear answer can be found to this question in Advocate General Geelhoed's four recent Opinions.

33. ECJ, Advocate General Geelhoed's Opinion, 27 April 2006, Case C-170/05, *Denkavit International BV Denkavit France SARL v. Ministre de l'Économie, des Finances et de l'Industrie,* Para. 44.

34. Clearly, in the authors' opinion, the source Member State cannot be prevented from levying a dividend withholding tax on outbound dividends if the home Member State taxes the inbound dividends in full. This would effectively result in the transfer of tax revenue from the source to the home Member State, which would deviate from the tax-sharing mechanism generally agreed on by the two Member States in a tax treaty. Such a position would also not be in line with the ECJ's view that, in negotiating a tax treaty, "the member states are at liberty to determine the connecting factors for the purposes of allocating powers of taxation" (ECJ, 5 July 2005, Case C-376/03, *D. v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen* [2005] ECR I-5821, Para. 52).

Switzerland

Swiss Supreme Court Decision on Treaty Abuse

Stefan Oesterhelt* and Maurus Winzap**

INTRODUCTION

Most Swiss tax treaties grant withholding tax reductions only to beneficial owners.[1] In addition, only a few Swiss tax treaties contain anti-abuse provisions.[2] By way of the (1962) Abuse Decree,[3] Switzerland adopted unilateral measures against the improper use of tax treaties. The (1962) Abuse Decree, however, only applies to payments made to a Swiss company (inbound). Notwithstanding the absence of applicable anti-abuse provisions in the Denmark–Switzerland tax treaty of 23 November 1973, the Swiss Supreme Court held for the first time in its decision of 28 November 2005[4] that, under international law, a reservation of abuse of rights is inherent in all tax treaties.

FACTUAL BACKGROUND TO THE DECISION

A Swiss company was 100% owned by a Danish holding company (DanCo). DanCo was owned by a Guernsey-domiciled company, which, itself, was owned by a Bermuda company. The sole shareholder and director of that company was a person resident in Bermuda. A refund of the 35% Swiss dividend withholding tax was, therefore, denied to DanCo.

RATIONALE FOR THE DECISION

The Supreme Court determined in its findings of fact that the reservation of the abuse of rights must be viewed as part of the principle of good faith based on Art. 26 and Art. 31(1) of the Vienna Convention on the Law of Treaties (hereinafter: the Vienna Convention). These provisions forbid the abuse of a legal principle to further interests that the legal principle is not intended to protect. As a result, under Para. 9.4 of the Commentary on Art. 1 of the OECD Model Convention (hereinafter: the OECD Model), this may be considered to be an internationally recognized principle, which provides that states are not required to grant the

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1. Exceptions are, inter alia, the tax treaties with Austria, Denmark, Ireland, Portugal, Spain and Sweden.

2. These include, in particular, the tax treaties with Belgium, France, Germany, Italy, the Netherlands, the United Kingdom and the United States. See the detailed comments in Lutz, *Abkommensmissbrauch* (Zurich: Schulthess, 2005), p. 103 et seq.

3. *Bundesratsbeschluss betreffend Massnahmen gegen die ungerechtfertigte Inanspruchnahme von Doppelbesteuerungsabkommen des Bundes*, 14 December 1962 (SR 672.202).

4. 2A.239/2005 of 28 November 2005.

benefits of a tax treaty when structures are selected that indicate the presence of treaty abuse.

The Supreme Court assumed that the Commentary on the OECD Model could be used as an aid to interpretation in answering the question of when treaty abuse arose. A suitable starting-point appeared to be the "look-through" clause recommended in Para. 13 of the Commentary on Art. 1 of the OECD Model. Neither the "general bona fide provision" of Para. 19(a) of the Commentary on Art. 1 of the OECD Model nor the "activity provision" of Para. 19(b) on Art. 1 applied. In casu, the tax relief would have been primarily for the benefit of persons resident outside Denmark, i.e. in Guernsey and, ultimately, Bermuda. As DanCo neither had its own office nor its own personnel and did not actually conduct any business activity in Denmark, it was simply a post office box company. In addition, as, apart from tax considerations, there were no apparent commercially significant reasons for a presence in Denmark, the Supreme Court held that the refund of the Swiss withholding tax had been correctly refused due to treaty abuse.

COMMENTS

Unwritten reservation of abuse of rights

The Supreme Court derived the reservation of treaty abuse from Art. 26 and Art. 31(1) Vienna Convention, to which the Court grants the status of customary international law. This confirms the Supreme Court's practice in respect of the Vienna Convention. With this justification of treaty abuse, the Supreme Court assumed that there is, under international law, a general reservation of abuse of rights. In its decision, the Supreme Court did not only recognize a general unwritten reservation of abuse of rights, but also made a clear statement on the question of what is its legal basis, and associated Switzerland with the group of treaty states referred to in Para. 9.4 of the OECD Commentary on Art. 1 of the OECD Model and Vogel's view that a prohibition on treaty abuse is "a general legal principle of civilized nations".[5]

Accordingly, the Supreme Court rejected the thesis that both parties to a tax treaty have implicitly agreed a reservation of abuse of rights if (but only to the extent that) the relevant principles are recognized in domestic law. Against this background, it is inexplicable why the Supreme Court examined whether or not Danish law recognizes an objection based on an abuse of rights. If the Supreme Court recognized the abuse of rights as a general international legal principle, the Danish (domestic) abuse provisions were, therefore, irrelevant.

The "look-through" clause

The decision of the Supreme Court to recognize a reservation of abuse of rights under international law is consistent with some of the academic literature and its previous decisions on the interpretation of the (1962) Abuse Decree. The establishment of this general reservation of abuse of rights as adopted by the Supreme Court on the basis of the "look-through" clause in Para. 13 of the Commentary on Art. 1 of the OECD Model should nevertheless have been rejected. Technically, this provision does not relate to the establishment of a general reservation of abuse of rights in Paras. 9.3 to 9.5 of the Commentary on Art. 1 of the OECD Model, but rather to a provision *suggested* by the OECD for inclusion in a tax treaty. It is, therefore, inappropriate to apply, tel quel, this provision that was not included by Switzerland in the relevant tax treaty.

An application of the "look-through" clause without an appropriate basis in a tax treaty should also not be permitted if the "look-through" clause is restricted by an "activity or bona fide" clause. The Supreme Court's statement that the "look-through" clause should be assumed to be, even if not explicitly, included in a specific tax treaty if the relevant entity does not engage in any genuine or active business activities is, therefore, questionable. This is also not supported by Para. 14 and 19 of the Commentary on Art. 1 of the OECD Model, which the Supreme Court cited.

"Ambulatory" interpretation of the OECD Commentaries

In relying on the "look-trough" clause, the Supreme Court reached its decision on the basis of changes to the OECD Commentaries that were made after conclusion of the Denmark–Switzerland tax treaty. This is regrettable, as such an "ambulatory" interpretation of the application of the OECD Commentaries is questionable, both in terms of international law and democratic principles.[6]

In this respect, the Supreme Court's reasoning is anything but convincing. The citation of the opinions of Vogel and Prokisch cannot directly support the position in respect of which the opinions are used.[7] The section of the OECD Commentaries that is referred to as a second basis for the ambulatory interpretation dates from 1992 and is, therefore, more recent than the 1973 Denmark–Switzerland tax treaty. In other words, the relevance of this point in the OECD Commentaries presupposes an "ambulatory" interpretation of the Commentaries and the position that it purports to support. A petitio principii of this kind is not helpful. An actual, material justification for the opinion of the Supreme Court is, therefore, lacking in the decision, as is any treatment of the many contrary opinions in academic literature.

Open issues

The Supreme Court justified its expansive interpretation of the general reservation of abuse of rights, inter alia, by the 0% rate in the Denmark–Switzerland tax treaty. In the light of Art. 15 of the Switzerland-EU

5. See Vogel, "Abkommensbindung und Missbrauchsabwehr", in Cagianut and Vallender (eds.), *Steuerrecht, Festschrift für Ernst Höhn* (Berne: Haupt, 1995), p. 472 and Prokisch, in Vogel and Lehner (eds.), 4th edition, *DBA-Kommentar* (Munich: Beck, 2003), Art. 1, note 117.

6. See Oesterhelt, "Internationale Steuerausscheidung von Betriebsstätten", *Forum für Steuerrecht* (2006/3), 4.3.2 with further references.

7. Vogel, note 5, notes 128 et seq. on the introduction. Note is only made of the practice then applying in Austria and Germany, which does not correspond to the authors' opinion on this issue.

Savings Tax Agreement (STA),[8] which provides a full exemption from source tax with regard to the Member States and the treaty revisions that resulted from the agreement, the reference by the Supreme Court to the special character of full treaty relief under the Denmark–Switzerland tax treaty appears to be somewhat out-of-date. It remains to be seen whether or not the Supreme Court, in relation to a tax treaty that envisages a residual tax, will apply a standard that is less strict.

It is also not clear what the Supreme Court means with its statements relating to the (1962) Abuse Decree and the 1999 Abuse Circular.[9] Based on the foundation of international law in respect of the treaty reservation of abuse of rights used by the Supreme Court, domestic anti-abuse provisions basically do not apply. Conversely, it is possible that the Supreme Court would allow the bona fide provisions of the 1999 Abuse Circular to have an effect on *outbound* dividends. This would be, in the authors' opinion, justifiable, as providing preferential treatment for *inbound* dividends as opposed to *outbound* dividends could expose Switzerland to a complaint based on *venire contra factum proprium.*[10]

In contrast to the court of first instance,[11] the Supreme Court left open the question as to whether or not the concept of beneficial ownership is an inherent principle in Swiss international tax law that would also apply in relation to those Swiss tax treaties that do not limit their treaty benefits to beneficial owners. A clarification of this question would have been helpful. The meaning of the concept of beneficial ownership, however, loses much of its original significance due to the expansive interpretation of the term "treaty abuse" adopted by the Supreme Court.

The Switzerland-EU relationship

In relation to Denmark and the other Member States reference must also be made of the significance of the decision for the withholding tax exemption in Art. 15 of the STA. The (full) refund of Swiss withholding tax on dividends payable on or after 1 July 2005 can now be based on Art. 15 of the STA. It should be noted that "Domestic or agreement-based provisions for the prevention of fraud or abuse" are explicitly reserved in the STA. The question then arises as to whether or not the general reservation of abuse of rights that the Supreme Court adopted in this case must also be complied with in the context of Art. 15 of the STA. As Art. 15 of the STA does not duplicate the OECD Commentaries,[12] this conclusion can only be drawn with caution. In the authors' view, this is only permissible to the extent that the general reservation of abuse of rights can be directly supported by the Vienna Convention.

In view of the relationship between Switzerland and the European Union, an obiter dictum[13] of the Supreme Court on the question as to the extent to which the EU freedom of establishment within the framework of the sectoral Switzerland-EU agreements must also be observed is of interest. Specifically, the Supreme Court succinctly concluded that the freedom of establishment set out in Art. 43 and Art. 48 of the EC Treaty has not, under any of the Switzerland-EU sectoral agreements or under the Agreement on the Free Movement of Persons (AFMP), "become, in a comprehensive sense, the content of the agreements with Switzerland".[14] Until such time as the relevant decisions are issued, it can only be speculated as to what this means. It is definitely conceivable that the Supreme Court wanted, per se, to prevent legal entities from making use of the freedom of establishment by way of the AFMP.

CONCLUSIONS

The Fiscal Committee of the OECD[15] as well as academic literature[16] stress that the non-observance of a treaty provision because of an unwritten reservation of abuse of rights can only be permitted under strict conditions. Through the application of the "look-through" clause without a basis in the tax treaty, the Supreme Court has violated this principle. In the authors' opinion, the international law principle, *pacta sunt servanda*, has, therefore, been neglected by the Supreme Court. The authors also believe that the "ambulatory" application of the OECD Commentaries, which the Supreme Court has explicitly adopted, should be rejected. It is, therefore, to be hoped that the Supreme Court will, in the future, refine its position with regard to these issues.

8. *Abkommen vom 26. Oktober 2004 zwischen der Schweizerischen Eidgenossenschaft und der Europäischen Gemeinschaft über Regelungen, die den in der Richtlinie 2003/48/EG des Rates im Bereich der Besteuerung von Zinserträgen festgelegten Regelungen gleichwertig sind* (SR 0.641.926.81).

9. *Kreisschreiben der Eidg. Steuerverwaltung vom 17. Dezember 1998 betreffend Massnahmen gegen die ungerechtfertigte Inanspruchnahme von Doppelbesteuerungsabkommen des Bundes*.

10. Riedweg and Heuberger, "Die Quellensteuerbefreiung von Dividenden, Zinsen und Lizenzgebühren nach Art. 15 Zinsbesteuerungsabkommen", *Forum für Steuerrecht* (2006), p. 118, even raise, with regard to the decision of the court of lower instance, the accusation of hypocrisy.

11. See the decision of the Swiss Federal Tax Appeal Commission, 3 March 2005 (SRK 2003-159), Para. 3.d.dd.

12. The reservation of abuse of rights is more correctly attributed to the EC Parent-Subsidiary Directive and the Interest and Royalties Directive. (See Danon and Gluster, "Cross-border Dividends from the Perspective of Switzerland as the Source State", *Intertax* (2005), p. 513; Oesterhelt and Winzap, "Quellensteuerbefreiung von Dividenden, Zinsen und Lizenzen durch Art. 15", *Zinsbesteuerungsabkommen*, ASA74 (2005/2006), p. 458; and Jung, "Verbot der rechtsmissbräuchlichen Steuerumgehung", *Schweizerischer Treuhänder* (2006), p. 90 et seq.)

13. The relevant tax treaties were not yet in effect when the dividends became payable.

14. See note 4.

15. See Para. 9.5 of the Commentaries on Article 1 of the OECD Model.

16. Vogel, note 5, p. 472; Prokisch, note 5; and Lutz, note 2, p. 99 et seq.