Swiss Supreme Court Sets Date for Total Return Swap Case

by Marcus Desax and Martin Busenhart

The Swiss Federal Supreme Court on April 13 announced that public deliberations in the total return swap case dating back to March 2012 have been set for May 5 in Lausanne.

The case involves the use of total return swaps with Swiss equities. A Danish bank had entered into total return swap agreements with several EU counterparties. To hedge its exposure, it acquired the requisite amount of Swiss shares. Under the then-applicable Denmark-Switzerland tax treaty of 1973, no withholding tax was levied on dividends paid to a Danish shareholder.

The Swiss Federal Tax Administration (SFTA) denied a refund on the Danish bank's declared dividend income, claiming that the bank lacked beneficial ownership and had engaged in treaty abuse. Interestingly, the Denmark-Switzerland tax treaty of 1973 did not contain the beneficial ownership language that was introduced in the OECD model convention in 1977.

The Danish bank appealed the case to the Swiss Federal Administrative Tribunal and claimed interest from the date of the tax authority's denial of the refund. In its judgment of March 7, 2012, the tribunal granted the refund but denied the claim for interest. It left the question open whether beneficial ownership is an unwritten requirement in a tax treaty that does not contain explicit language. In the case at issue, it held that beneficial ownership did exist because the tribunal found no interdependence between the receipt of dividends and the payment under the swap. (Prior coverage.)

The tribunal did not examine the issue of treaty abuse, referring to a dictum in the famous Supreme Court case, *A. Holding ApS*, of 2005, according to which the issue of treaty abuse does not arise if the recipient of the dividend carries on an active trade or business, which was obviously the case. However, the tribunal refused the claim of interest with the argument that neither the tax treaty nor Swiss domestic law provides for it.

In April 2012 both the SFTA and the bank filed complaints with the Court. The SFTA argued that it was obvious that there was interdependence between the swap and the hedge. It reiterated its position that beneficial ownership is a requirement for a refund even if the treaty does not specifically mention it. As to treaty abuse, it argued that the Federal Administrative Tribunal did not consider itself to be in a position to effectively police such cases.

The bank seized on the fact that the Swiss Court based its argument for interest on the nondiscrimination clause of the tax treaty. Under Swiss domestic law, a Swiss unlimited taxpayer is entitled to interest if the payment of taxes is in accordance with

a taxing decision that is later overturned. A nonresident holder of Swiss shares is subject to limited tax liability in Switzerland, the taxpayer argued. The SFTA's decision denying the refund was tantamount to a taxing decision with regard to its limited tax liability, it said.

The case has been pending before the Supreme Court for three years, which is almost a record. Similar cases are decided within six to nine months after they are filed. This is an indication that the Court faced considerable internal disagreements. When the representative of the taxpayer contacted the Court in October 2014 about the status after two years, the clerk said the Court needed more internal and possible external discussions. As it now appears, the internal discussions have not resulted in a unanimous decision.

If the Supreme Court justices are unable to reach a unanimous judgment, they are required by law to deliberate in public. Eventually, a vote is taken and the case is decided by majority. There are no party pleadings before the Court, the case being based entirely on the record. The Swiss requirement of deliberations in public is a substitute for dissenting opinions that are not published.

The case involves many interesting issues, some of which will be decided for the first time by the Supreme Court:

- Has the SFTA pleaded property? As mentioned, the lower court held beneficial ownership to exist because it found no interdependence between the receipt of the dividend and the payment under the swap. The SFTA did not address that relationship in its complaint; rather, it argued the obvious -- that there was an interrelationship between the hedge and the swap. Usually, the Supreme Court is very strict with the requirement of proper pleadings. Should it find the pleadings to be insufficient, it may not enter upon the SFTA complaint.

- Is beneficial ownership an unwritten requirement even in an old treaty that does not contain specific beneficial ownership language? If so, what are the components of beneficial ownership? Does a more recent commentary provide guidance for the interpretation of an older treaty? What is the impact of the 2014 change to the OECD commentary to treaty article 10 MC?

- Does the dictum of *A Holding ApS* provide any guidance regarding treaty abuse? Does the use of a fully hedged total return swap constitute treaty abuse?

- With regard to interest, is discrimination against a nonresident corporate taxpayer on account of nationality and therefore outlawed by the nondiscrimination clause of the treaty? Is the denial of the refund by the SFTA tantamount to a taxing decision? If the law grants interest to an unlimited taxpayer that had paid the tax in accordance with a taxing decision that is later reversed, can a limited taxpayer that eventually obtains a refund be refused interest?

There will be a whole slew of interesting issues to be decided.

At the end of the public hearing, the Supreme Court will vote on the operative language of the judgment (whether the refund is denied or granted and, if granted, whether the taxpayer gets interest). The fully reasoned judgment will be delivered to the parties later. In this case, it can be expected that the fully motivated judgment is already available and that the public session is necessary only because one or two justices disagree with it. Hence, the fully reasoned judgment can be expected shortly.

Marcus Desax and Martin Busenhart, Walder Wyss Ltd., Zurich. The authors represent the taxpayer before the Swiss Federal Supreme Court.