Switzerland

The application of a double tax treaty needs to be confirmed with all relevant tax authorities

 

Flurin Poltera and
Stefan Laganà,
Deloitte

In a recent case an investor acquired Swiss real estate via a Luxembourg holding company with the intention of achieving both tax efficient profit repatriation and tax efficient exit in regard to his investment. The Swiss – Luxembourg double tax treaty (Swiss-Lux DTT) – as do many of the more than 90 double tax treaties Switzerland has in force – foresees a 0% residual withholding tax on dividends if a minimum shareholding is met. The investor filed a ruling request with the Swiss Federal Tax Administration (SFTA) which confirmed the substance requirements for the application of the Swiss – Lux DTT and the zero withholding tax on dividends are met.

The Swiss – Lux DTT does not contain paragraph 4 of article 13 of the OECD Model Tax Convention, which would allow the property country (Switzerland) to tax capital gains of real estate companies in case of an exit. Luxembourg has, therefore, the right to tax a capital gain of the Luxembourg holding company on the sale of its Swiss real estate company, if the treaty applies.

In relation to capital gains it is important to understand that the competence to assess income taxes, even federal income taxes, in Switzerland is with the cantonal tax authorities; for real estate tax in certain instances with the communal authorities. Different authorities can come to different conclusions in assessing the tax consequences of a certain transaction from their angle of responsibility.

In the case of the above-mentioned investor, the cantonal tax authorities considered the ruling granted by the SFTA for withholding tax purposes as not binding for cantonal tax purposes. They took the position that the Luxembourg holding company did not meet the substance requirement under the Swiss-Lux DTT for purposes of the real estate gains tax and that therefore the capital gain was subject to taxation in Switzerland. The decision was upheld by the cantonal court.

The SFTA recently tightened their practice in relation to substance requirements, allegedly considering international tax developments, in particular the OECD initiative on base erosion and profit shifting (BEPS). While there are no official guidelines or formal substance requirements, recent experience showed that the SFTA, in addition to the 30% minimum equity requirement for holding companies, requires a real nexus to the country of the holding company and is putting more emphasis on operational substance and some economic rationale for choosing the holding jurisdiction. The tightened practice must be carefully considered when implementing international holding structures.

The case described above clearly demonstrates that it is important to review existing structures for two reasons: to consider whether companies are compliant with substance requirements and, particularly in the case of real estate investments, to assess whether for a particular structure an additional ruling may be recommendable for real estate gains taxes with the cantonal tax authorities to ensure and safeguard the tax efficiency of the structure.

Flurin Poltera (fpoltera@deloitte.ch) and
Stefan Laganà (slagana@deloitte.ch)
Deloitte
Tel: +41 58 279 7217 and +41 58 279 6313
Website: www.deloitte.ch