WORLD TAX

TAX CONTROVERSY LEADERS

THE COMPREHENSIVE GUIDE TO THE WORLD'S LEADING TAX CONTROVERSY ADVISERS

TENTH EDITION

IN ASSOCIATION WITH

ITR

WWW.INTERNATIONALTAXREVIEW.COM

PUBLISHED BY

LMG LEGAL MEDIA GROUP RESEARCH

SWITZERLAND

Strengthening legal certainty and transparency in the mutual agreement procedure in Switzerland

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Introduction

As an important group location for multinational companies Switzerland has many years of in-depth experience with mutual agreement procedures (MAPs). An analysis of all MAPs concluded by the end of 2017 shows that of the approximately Fr17 billion in adjustments originally claimed by foreign tax authorities, around a quarter (i.e. more than Fr4 billion) were effectively adjusted within the framework of a MAP. These figures clearly demonstrate that MAPs are a crucial and efficient dispute resolution instrument for Switzerland as a business location.

Given this starting point, it is surprising that important domestic procedural issues such as the rights and obligations of the taxpayer, time limits and the implementation of a mutual agreement are still not legally standardised in Switzerland. A considerable number of MAPs have significant financial implications for the Federation, the cantons and the municipalities. This aside, there are relevant differences of opinion on certain procedural law matters between the competent authority responsible for the MAP, namely the State Secretariat for International Financial Matters (SIF), and the cantonal tax authorities responsible for implementing the MAP. Therefore, it is highly welcomed that the Federal Council is now attempting to regulate the domestic procedural issues in the Federal Act on the Implementation of International Tax Agreements (ITAIA). The draft law, which is currently in consultation, distinguishes between the request, the conduct and the implementation of the MAP. The new provisions are scheduled to enter into force in the latter half of 2021.

Request for the MAP

This stage of the procedure verifies that the conditions for conducting a MAP are met. The taxpayer affected by taxation contrary to the Double Taxation Agreement (DTA) is a party to this procedure. He or she may lodge an appeal with the Federal Administrative Court within 30 days if the SIF rejects the MAP request.

Throughout the entire procedure, the taxpayer must provide all pertinent facts that may be relevant to the MAP and supply information and necessary documents, otherwise the MAP request may be denied.

BEPS Action 14 Minimum Standard requires that the threshold for requesting a MAP be set as low as possible. Admission to the MAP must be granted by the competent authority if in either of the Contracting States there is, or it is reasonable to believe that there will be, taxation not in accordance with the DTA. According to BEPS Action 14 Minimum Standard, this applies even if there is disagreement between the taxpayer and the tax authorities about the application of treaty or domestic law anti-abuse provisions. Similarly, an audit settlement reached by the taxpayer and the assessing tax authority in the course of a tax audit, may not lead to the exclusion of a MAP.

In Switzerland, nonetheless, various cantonal tax authorities are of the opinion that a taxpayer should be excluded from utilising a MAP if a possible international double taxation, already in the assessment procedure, is recognisable to the taxpayer with all due diligence. The authorities argue that a general provision should be included in the ITAIA under which a MAP request can be refused in the event of a breach of the principle of good faith. However, such a provision would violate the BEPS Action 14 Minimum Standard and create new legal uncertainties. If a state claims more tax base as a result of treaty abuse or domestic law anti-abuse provisions there is no reason, from a tax-systemic perspective, why a resulting double taxation should not be eliminated under a MAP. It is not the task of treaty law but that of domestic criminal tax law to penalise abusive arrangements. On the basis of these considerations it is correct that the current draft consultation does not exclude a MAP request if a tax authority invokes the application of an anti-abuse provision. Admittedly, a generous approval of a MAP does not alter the fact that, even under the Minimum Standard in force, there is no obligation to reach an agreement and that a competent authority can refuse to eliminate double taxation resulting from the application of treaty abuse or domestic law anti-abuse provisions. The only remedy would then be arbitration proceedings – if the DTA contains an arbitration clause – or possibly a domestic appeal procedure.

Conduct of the MAP

Once the request procedure has been completed and the MAP has been entered into, the MAP will be conducted unless the double taxation can be eliminated by a unilateral measure taken by the Swiss tax authorities. During the conduct of the MAP the taxpayer is not a party thereto and may neither inspect the files of, nor participate in, the procedure. Nevertheless, unlike in many other countries, MAP applicants can obtain information on the status of the proceedings from the SIF. Furthermore, and on their own initiative, applicants have the option of sending further comments and documents to the competent authority.

Another special feature of the Swiss procedure is that the Federal and cantonal tax authorities are involved in the procedure, whereby the SIF informs the responsible Swiss tax

authorities about all cases of mutual agreement that affect them. If a case concerns taxation in Switzerland, the responsible tax authorities are given the opportunity to comment.

Additionally, the SIF may involve an authority of a State which is not a party to the applicable DTA in a MAP, or delegate the conduct of negotiations to that authority. This for instance, allows Switzerland, as the State of residence of the head office, to delegate the conduct of negotiations to the State of the permanent establishment. However, the potential to delegate does not alter the fact that in such cases the agreement must ultimately be concluded by the SIF. In turn, the SIF can engage in negotiations to safeguard the tax interests of Switzerland, even if only the permanent establishment is located in Switzerland. Needless to say, delegations of this nature are only possible if all participating states agree or respectively, offer their hand in support.

In clear-cut cases, the SIF can agree with the affected federal or cantonal tax authority to make a domestic – and therefore unilateral – adjustment, without conducting a MAP and involving the other state. In this respect it should be noted that, according to current practice, the competent cantonal tax authority in various cantons already make corresponding adjustments on their own authority and without involving the SIF, provided that the foreign primary adjustment is justified. In our opinion, this efficient practice can and should continue, even after the inception of the ITAIA.

Implementation of the MAP

Following notification from the SIF, the mutual agreement solution must be implemented *ex officio* by the competent tax authority. If the tax year has already been finally assessed, the assessing tax authority issues an implementation order. This instrument is new. Up to now, a mutual agreement solution has been implemented by way of a revision of the original final assessment. An implementation order represents a simplification, compared to the previous revision solution. However, this approach meets with resistance, particularly from the cantonal tax authorities.

It is controversial whether a mutual agreement can be implemented even if it contradicts a (supreme) court ruling. Due to the principle of separation of powers, various cantonal tax authorities have taken the position that a mutual agreement that contradicts a decision of the highest court should not be implemented. In this respect, however, it should be noted that domestic tax collection procedures and the MAP are two distinct procedures, with different requirements and rules. Thereby, the MAP aims to avoid taxation contrary to the DTA and, in particular, double taxation for the person(s) concerned. In order to achieve this the competent authority may also include equity considerations in individual cases, which a domestic court may not consider in double taxation conflicts, due to the strict principle of legality. A mutual agreement solution should therefore also be implemented if it contradicts a decision of the highest court. It would be welcomed if a corresponding provision were to be included in the ITAIA in this regard.

BEPS Action 14 Minimum Standard requires that MAPs be implemented independent of domestic time limits. However, states may make a reservation in this respect, which Switzerland has done. Accordingly, very few Swiss DTAs provide for an obligation to implement MAPs regardless of the time limits under domestic law. According to the new BEPS Action 14 Minimum Standard, Switzerland may only maintain its previous DTA practice if it

is prepared to accept provisions within the framework of DTA negotiations, which restrict the time limit for profit adjustments of affiliated enterprises or permanent establishments. In view of this context, the current draft ITAIA provides that the assessing tax authority does not have to implement the mutual agreement if the MAP request is submitted more than 10 years after the final assessment was issued. Whilst business associations would like to dispense with a time limit altogether, the cantonal tax authorities advocate a tightening up of the proposed regulation. It is likely that the current proposal will be accepted by parliament as a compromise solution.

Assessment

The proposed ITAIA represents an important step towards increasing legal certainty and transparency in the MAPs. However, we believe there are various gaps in the proposal, which require resolution as follows:

- APAs, which are likely to become even more important for multinational companies in the future, are excluded from the present draft devoid of convincing rational.
- The ITAIA should explicitly state that a MAP request will suspend any domestic appeal proceedings.
- The existing practice for international profit adjustments is that secondary adjustments are not considered as deemed dividend distributions subject to withholding tax, and will only be regarded as such if the SIF recognises them within the framework of a MAP. Such a limitation of this correct practice is no longer appropriate and cannot be justified from a tax-systematic perspective. Primary and secondary adjustments should always be possible without withholding tax consequences if they comply with the arm's length principle, irrespective of whether a mutual agreement exists.

If these issues are resolved in the ongoing legislative process, and deterioration to the detriment of taxpayers is prevented, Switzerland will have robust internal regulations for international dispute resolution and dispute prevention, which will further strengthen its position as a business location.