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Switzerland's new rules on mutual agreement procedures seeks to ensure legal certainty

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Switzerland's new rules on mutual agreement procedures seeks to ensure legal certainty

The new legislation governing Switzerland's network of double tax agreements responds to the OECD's minimum standards in preventing treaty abuse and improving the dispute resolution process. **Rolf Wüthrich** of **burckhardt Ltd** explores the commercial and tax implications of these positive developments.



In December 2019, the Swiss Federal Council initiated the consultation on the Federal Act on the Implementation of International Tax Agreements (ITAIA). With the proposed law, it is intended to replace the Federal Act of 22 June 1951 on the Implementation of International Federal Conventions on the Avoidance of Double Taxation (the 1951 Act) in order to react to the recent developments in international tax law. The consultation will end in March 2020. The ITAIA is expected to enter into force in the second half of 2021.

The ITAIA shall ensure that international tax agreements, particularly double taxation agreements (DTAs), can be applied easily and in legal certainty. It stipulates how mutual agreement procedures (MAPs) shall be handled at domestic level. The proposed rules largely codify current Swiss practice and only apply if an applicable DTA does not contain prevailing provisions. Furthermore, the ITAIA contains new provisions for withholding tax relief based on DTAs as well as criminal provisions in connection with unjustified claiming of tax credits.

This article focuses exclusively on the proposed new provisions applicable to MAPs.

Need for action

Switzerland has concluded DTAs with more than 100 countries which will primarily regulate the allocation of taxation rights and the exchange of information between the Contracting States. The main purpose is to avoid international double taxation and non-taxation or reduced taxation through tax evasion and avoidance.

Apart from the rules for international administrative assistance procedures in tax matters there are only a few legal provisions regarding the domestic implementation and application of international agree-

ments concluded by Switzerland. The 1951 Act and certain ordinances issued on the basis of this act currently regulate the implementation and application of DTAs.

Since its entry into force, the 1951 Act has been amended only occasionally. It consists of four articles, which authorise the Federal Council to issue further regulations by ordinance. This law only partially meets today's requirements. International tax law is continually developing. Social behaviour and workflows have dramatically changed over the last decades, especially in the area of MAPs. Increasing the effectiveness of MAPs is an important part of the OECD's BEPS Project and the Inclusive Framework (Action 14, minimum standard). The replacement of the 1951 Act by the ITAIA is necessary to take into account these recent tax developments and to ensure the implementation of the minimum standards.

The first Swiss DTAs in the first half of the last century already provided for MAPs to avoid taxation contrary to an agreement. Switzerland has always carried out MAPs. However, the number and the amounts in question have lately significantly multiplied, especially in transfer pricing. The reasons for this increase are manifold: growing international interdependence of companies and individuals, expansion of the DTA network or international efforts against profit shifting (e.g. OECD's BEPS Project).

Purpose of the ITAIA

The main purpose of the ITAIA is the creation of a legal basis for the implementation of MAPs. MAPs are international procedures based on an international agreement (e.g. DTA), in which the authorities of the Contracting States try, at the taxpayers' request, to find a remedy for a disadvantage resulting from the breach of such agreement. Since the number of MAPs has significantly increased in recent years, a domestic legal basis is necessary to initiate and enforce these procedures.

DTAs only regulate the implementation of a MAP between Contracting States. Important domestic procedural rules applicable to MAPs (rights and obligations of taxpayers, statute of limitation, implementation of a mutual agreement, etc.) are not standardised by Swiss law. Although a domestic legal practice on MAPs has developed over time and as long as all involved Swiss parties (cantonal and federal tax administration, taxpayer and State Secretariat for International Financial Matters (SIF) as competent authority) have the same opinion on this practice, the lack of a legal basis does not cause any significant application problems. However, as reality has shown, the involved parties may from time to time have different opinions, (e.g. questions regarding status of limitation or procedure for implementing MAPs), which leads to uncertainty. Therefore a legal basis is required to implement MAP agreements on domestic level.

Proposed new MAP regulations

In a MAP between Contracting States, a taxpayer is not a party to the procedure. Nevertheless, they will have various rights and obligations, in particular it is their responsibility to initiate a MAP. The initiation procedure of a MAP will be regulated in the ITAIA. Furthermore, a so-called implementation decision (Umsetzungsverfügung) shall be issued by the competent tax authorities to ensure a smooth domestic implementation of the MAP agreement reached by the Contracting States. Due to such an implementation decision, the Swiss tax authorities can implement a mutual agreement by overruling binding decisions on a matter in question.

The ITAIA shall apply to MAPs carried out on request of a taxpayer to avoid existing or foreseeable taxation not complying with an international agreement. Subject to a MAP is always a specific individual case. The Swiss legal basis for a MAP is found in international agreements, and not in domestic law. Such basis is almost exclusively found in DTAs, although other international agreements can as well provide for MAPs (e.g. the Federal Act on International Administrative Assistance in Tax Matters; AIA Agreement). The OECD Model Convention (OECD MC) regulates MAPs in Art. 25. In principle, Switzerland incorporates this article into its DTAs. Art. 25 paras. 1 and 2 OECD MC concern MAPs initiated by a taxpayer in individual cases and para. 3 concerns the general mutual agreement or consultation procedures to resolve difficulties and doubts in the interpretation or application of the agreement between the Contracting States. The ITAIA does not apply to Art. 25 para. 3 OECD MC, which are carried out between the Contracting States without a request of a taxpayer; as a consequence, para. 3 does not require any further national procedural provisions. Finally, Advance Pricing Arrangements (APAs) between associated enterprises are not covered by the ITAIA. Although APAs are initiated at the request of taxpayers, they do not meet the requirement of existing or imminent taxation contrary to an agreement.

MAPs covered by Art. 25 para. 2 OECD MC are characterised by the fact that they are initiated by a taxpayer because taxation in contrary with a DTA has occurred or is at least threatened. The authorities to whom the request is addressed subsequently initiate the intergovernmental procedure if the conditions of the DTA for a MAP are met and if taxation in conformity with the DTA cannot be ensured by the authorities without initiating a MAP. The ITAIA states that in clear situations a domestic correction of the unlawful assessment shall be possible without initiating a MAP. If the Swiss tax authorities and the SIF agree to such a Swiss correction, then the correction shall be made without involving the other Contracting State. The later shall, however, be informed by Switzerland about the correction.

MAP negotiations are carried out exclusively between the governmental authorities. From an international law point

of view, a MAP is comparable to a diplomatic way of dispute settlement. The authorities have considerable leeway as to how the procedure shall be approached. Normally, DTAs do not provide for a specific procedure or an obligation to reach a consensus between the authorities under a MAP (cf. Art. 25 para. 2 OECD MC “the competent authority shall endeavour”). It is a sui generis procedure not comparable to a domestic appeal procedure. Only if a DTA contains a MAP arbitration provision, a solution in a MAP is guaranteed.

Communication between authorities is confidential and access to the file is not granted, unless documents are filed by the taxpayer, for which the right for inspection of the file is granted. The exclusion of taxpayers is intended to facilitate the solution finding between the authorities, especially for compromises. It is inevitable that one or both authorities will give up their initial position to remedy the questioned assessment.

MAPs are independent of national (appeal) procedures. A person suffering taxation contrary a DTA can continue domestic procedures and take legal actions as well as request for implementation of a MAP. Due to this parallelism of procedures it is important to ensure that double taxation or unintentional double non-taxation does not occur as a consequence of a MAP. Therefore, the consent of the taxpayer affected by a MAP must be obtained before a mutual agreement is implemented in Switzerland. Such consent also includes a waiver of appeal rights, which prevents possible ongoing domestic appeals leading to decisions contrary to the MAP. If the taxpayer refuses to consent, the original assessed Swiss taxation remains in force and the mutual agreement is not implemented.

A person requesting a MAP is not party to this intergovernmental procedure. Therefore, the initiation and the procedure as such is free of charge. However, the taxpayer will neither be compensated for expenses suffered (e.g. legal representation).

MAP request

The applicable DTA defines in which Contracting State a MAP must be initiated. If such an initiation request is submitted in Switzerland, the intergovernmental procedure is preceded by a domestic initiation procedure. The aim of such an initiation procedure is to clarify whether the requirements for conducting a MAP are met. The competent authority for conducting MAPs by Switzerland is the SIF. The request for a MAP must therefore be filed in writing with the SIF; no oral request is accepted.

The initiation request must contain a request, a motivation and documentary evidence. It must be submitted in one of Switzerland’s official languages or in English. During the entire MAP the requesting person must provide, if requested by the SIF, additional information and documents. The SIF publishes guidelines how to initiate a MAP.



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burckhardt Ltd. provides its clients and their businesses with comprehensive advice on national and international tax planning issues and structuring, offers corporate general, secretarial and notary service, supports clients with professional expertise and broad international experience on restructurings, mergers and joint ventures, advises on inbound and outbound investments as well as on financing and in all matters related to employment, trade and transport law as well as media law.

For a MAP as such, no rules exist on the burden of proof concerning intergovernmental procedure. It is therefore of particular importance that a requesting person documents the competent authorities as exhaustive as possible to ensure that the latter gets a comprehensive picture of the relevant facts. If the taxpayer fails to do so or provides insufficient information during the initiation procedure, the request can be rejected.

It is common understanding that the threshold for the initiation of a MAP must be low. Only if basic requirements are not met a MAP shall not be initiated, e.g.:

- The initiation requirements under the DTA are not met (e.g. no initiation within 3 years or no taxation contrary to the DTA);
- The initiation request does not contain the minimum requirements (request, motivation, documentary

evidence, wrong language) and such failure is not corrected in time; or

- If the SIF is unable to get a clear picture on whether or not a request is well-founded and, if so, to what extent the taxation contrary to the international agreement is caused by Switzerland or the Contracting State, it may refuse the request.

Involvement of tax authorities and administrative assistance

The SIF will inform the assessing Swiss tax authorities about the MAP request. If taxation in Switzerland may be affected by the MAP, the tax authorities get the right to comment on the case. The opinion of the tax authorities is an important element of the Swiss position vis-à-vis a Contracting State as the tax authorities are most familiar with the specific facts of a case.

In order to get a full picture on the facts, it is important for authorities to obtain information. The ITAIA therefore regulates administrative assistance between Swiss authorities in order to exchange information. International administrative assistance on the other hand is governed by the corresponding rules in the international agreements, e.g. the DTAs.

New delegation rules for permanent establishments cases

The ITAIA stipulates new rules where the allocation of profits between permanent establishments (PEs) and affiliated companies is disputed. As a PE is not considered a resident person for treaty purposes, the PE State cannot, according to the provisions currently used in the DTAs, agree directly with the State of the group company on the issue in question within the framework of a MAP. Such constellations are not yet covered by DTAs. Instead, the DTA between the State of residence of the group company and the State of residence of the head office (HO) of the PE is applicable. However, since the HO State may not have any interest in a MAP because only taxation in the PE State is affected, such constellations may lead to unsatisfactory results.

The ITAIA contains for such situations delegation rules to ensure that the States whose tax interests are affected can conduct a MAP or at least be involved in such procedure: (i) If Switzerland is the HO State, then it shall be possible to delegate the conduct of negotiations of a MAP to the PE State; or (ii) if Switzerland is the PE State, then the SIF shall be allowed to engage in MAP negotiations to safeguard the tax interests of Switzerland. It is understood that these new delegations rules are only applicable if all involved States agree hereto.

Non-challengeable intergovernmental procedures

MAPs have their basis in international agreements and Contracting States are obliged to implement MAP results, which qualify as such as agreements under international law. If a MAP ends with the conclusion of a mutual agreement, the SIF will inform the requesting taxpayer in Switzerland of the outcome. As a mutual agreement is an arrangement under international law between two Contracting States, it is not addressed to the taxpayer like an order. Neither the conclusion nor the content of the mutual agreement can be challenged by a national appeal. However, newer DTAs often provide for the possibility of arbitration proceedings if the Contracting States cannot agree on a solution within a certain period of time. However, such an arbitration proceeding is not a stand-alone procedure, but is part of an initiated MAP.

Implementation of MAPs

If a MAP agreement affects Swiss taxation, a further domestic action is necessary to implement the MAP result. The ITAIA provides for an ex officio implementation of the mutual agreement by the tax administration after notification of it by the SIF. The formalities for implementation depend on the tax concerned and the actual status of the domestic procedure. If e.g. the tax year in question is not yet assessed, it is sufficient to take into account the mutual agreement result in the course of the ordinary assessment.

If it is no longer possible to implement the mutual agreement ex officio in an assessment, execution shall be ensured by issuing an implementation decision. The ITAIA contains a new legal basis that allows tax authorities to implement MAP agreements by such implementation decision. The execution of the MAP agreement by such special implementation decision corresponds to the concept of Art. 25 para. 1 OECD MC, which assigns the MAP a role independent of domestic procedures.

Subject of an implementation decision is the outcome of a MAP. The outcome may result in an increase or a reduction of the original tax burden. As a taxpayer must agree to the mutual agreement, which he will only do if the overall outcome is beneficial for him, the interests of the taxpayer is safeguarded even if taxation in Switzerland is increased.

A taxpayer may appeal against the incorrect domestic implementation of a MAP agreement by the tax authorities, but cannot appeal against the MAP agreement between the Contracting States as such.

Transitional provision

To avoid overlaps in MAPs, the ITAIA stipulates that the new rules shall only apply to MAPs which are notified to the tax authorities by the SIF after entry into force of the ITAIA.