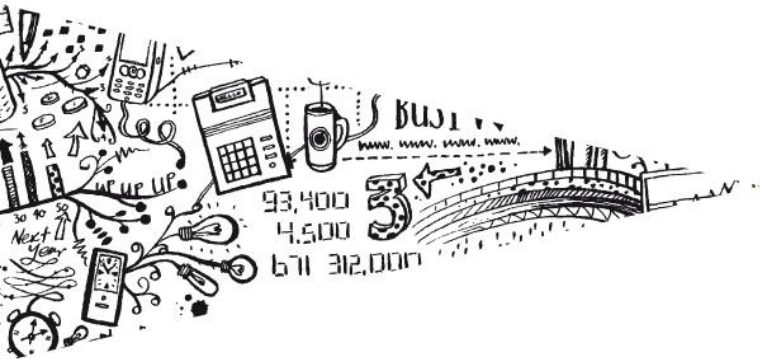


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EY Tax Alert

Amendments to India tax treaty with Switzerland



Executive summary

This Tax Alert summarizes the key changes made to the existing double taxation avoidance agreements (DTAAs) entered into by India with Switzerland. The 1994 DTAA between India and Switzerland and the appended protocol (Swiss DTAA) has been amended *vide* a Protocol which was concluded on 30 August 2010 and has entered into force from 7 October 2011 (Swiss Protocol). The Swiss Protocol has been notified [*vide* Notification No. 62/2011] on 27 December 2011 and shall be effective in India in respect of income arising in any fiscal year beginning on or after 1 April 2012.

The Swiss Protocol incorporates provisions for taxation of profits from the operation of ships in international traffic, replaces the first paragraph of the business profits article to align it with Article 7(1) of the 2008 OECD Model Convention (MC) and, in the process, deletes the reference to the expression 'directly or indirectly' and the consequent explanation of the expression in the existing protocol to the Swiss DTAA. The Swiss Protocol also amends the definition of 'resident' to include a recognized pension fund or pension scheme and incorporates a most-favoured nation (MFN) clause for a lower rate in respect of dividends, interest, royalties and fees for technical services (FTS) income streams. At the same time, it also introduces an anti-abuse provision that applies to the articles dealing with the above income streams and also the other income article. The Swiss Protocol has updated and enhanced the provisions relating to exchange of information and the assistance in the collection of taxes.

This Tax Alert provides a summary of the key amendments brought about to the Swiss DTAA *vide* the Swiss Protocol.

Amendments to the Swiss DTAA

Article 8 - Taxation rights for shipping and air transport

- ▶ Under the existing Swiss DTAA, profits derived by a Swiss enterprise (or a foreign enterprise - FE) from operation of aircraft in international traffic are taxable only in Switzerland. The taxing rights with respect to income from operation of 'ships' in international traffic was not specifically provided for, though it was specifically excluded from Article 7(1) on business profits^[1]. In addition, gains from alienation of ships or aircraft operated in international traffic or moveable property pertaining to the operation of such ships/aircrafts are taxable under Article 13(3) only in the State in which the place of effective management (POEM) of the FE is situated.

^[1] It may be noted that the existing DTAA provides for an exclusion from taxation of a FE's business profits with respect to operation of ships in international traffic (under Article 7). The AAR, in the case of Gearbulk AG, held that such profits were specifically dealt with under Article 7 (because of the specific exclusion) and, accordingly, cannot come under the residuary article. Therefore, the taxation rights on such profits were not allocated under the DTAA and, hence, would be taxable under the Indian tax laws.

- ▶ The Swiss Protocol amends Article 8 by including the profits from the operation of ships (in addition to aircraft) in international traffic as taxable only in the State of the FE. Correspondingly, Article 7 (business profits), which specifically excluded the FE's profits from the operation of ships in international traffic, has now deleted the reference to the same. The article on 'general definitions' (Article 3) has been amended to include transport by ship within the purview of the term 'international traffic'. Further, reference to income from operation of ships in international traffic with respect to Article 11 (interest) and Article 13 (capital gains), has been correspondingly amended to also include reference to shipping income and taxation rights to the State of the FE in Article 13 (as against taxation rights to the State where the POEM of the FE is situated).

Article 7 - Business profits

- ▶ Article 7(1) of the existing Swiss DTAA provided for the Source State to tax so much of the profits as is 'directly or indirectly' attributable to that PE. The existing protocol to the Swiss DTAA explained what the expression 'directly or indirectly' meant. In addition, there was an exclusion provided for operation of ships in international traffic.
- ▶ The Swiss Protocol amends Article 7 by substituting the above provision with Article 7(1) of the 2008 OECD MC. Consequently, the references in the Swiss Protocol to the meaning of the expression 'directly or indirectly' have also been deleted.

Article 26 - Exchange of information

Article 26 has been amended to enhance the scope of exchange of information between the two countries. Significantly, it has the following features:

- ▶ The competent authorities of the two countries shall exchange information as is 'foreseeably relevant' for carrying out the provisions of the DTAA. This is to provide for exchange of information in tax matters to the wildest possible extent without allowing either country to engage in 'fishing expeditions' or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer. For this purpose, request for information can only be made once all the normal procedures under the domestic law of the requesting country have been exhausted. Further, information requests must contain details such as the name of the person under examination or investigation and, if available, other prescribed particulars facilitating that person's identification such as address, date of birth, marital status, tax identification number, including the period of time for which the information is requested.
- ▶ On an information request, made by either India or Switzerland, the other country shall use its information-gathering measures to obtain the requested information, even though the other country may not need such information for its own tax purposes. Subject to certain conditions, the other country shall not decline to supply information solely because it has no domestic interest in such information.

- ▶ The other country shall not decline the information request solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person. The tax authorities of such country shall have the power to enforce the disclosure of information notwithstanding any contrary provisions in the country's domestic laws.
- ▶ Any information received shall be subject to a secrecy clause, whereby, the information contained therein shall be treated as secret as under the domestic laws of either State and shall be disclosed only to certain judicial or quasi-judicial authorities. The information may be disclosed in public court proceedings or in judicial decisions.

MFN clause and introduction of anti-abuse provisions

- ▶ Presently, the Swiss DTAA provides for the Source State to levy a 10% withholding tax on gross basis on interest, dividends, royalty and FTS income streams (Articles 10, 11 and 12). Though a MFN clause (in relation to limitation of source country taxation rights) exists, it only provides for the countries to enter into negotiations to extend such beneficial treatment to Swiss residents as well when it is provided to an OECD member country.
- ▶ The Swiss Protocol amends the provision so as to make the MFN clause applicable automatically, but, with respect to only a lower rate of tax on

dividends, interest, royalties or FTS income streams that is present in any DTAA by India enters into force with an OECD member subsequent to the signing of the Swiss Protocol (i.e., 30 August 2010). The existing MFN clause with respect to a more restricted scope of source taxation on royalties or FTS income streams continue to apply and, hence, in such cases, there is only an enabling provision for India and Switzerland to enter into negotiations to extend such beneficial treatment to Swiss residents.

- ▶ The Swiss Protocol also amends the existing protocol to the DTAA by introducing an anti-abuse provision wherein the beneficial provisions in respect of articles on dividends, interest, FTS or other income (Articles 10, 11, 12 and 22, respectively), shall not apply if the same is paid under or as part of a conduit arrangement. A conduit arrangement is defined to mean a transaction or series of transactions which is structured in such a way that:
 - ▶ a FE receives an item of income from the Source State and pays, directly or indirectly, all or substantially all of that income (at any time or in any form) to another person who is not a resident of either India or Switzerland (third person); and
 - ▶ if such third person, receiving the income directly from the Source State, would not be entitled:
 - ▶ under a DTAA between the third person's State and the State from which the income arises (Switzerland or India), or
 - ▶ to benefits at least equal to the benefits available under the Swiss DTAA; and
 - ▶ the main purpose of such structuring is to obtain the benefits under the Swiss DTAA

Swiss DTAA now accessible to certain pension funds/schemes

- ▶ The existing protocol to the Swiss DTAA has been amended to clarify that the term 'resident of a Contracting State' includes a recognized pension fund or pension scheme in that Contracting State. This means any pension fund or pension scheme recognized and controlled according to the statutory provisions of that State, which is: (i) generally exempt from income taxation in that State; and (ii) operated principally to administer or provide pension or retirement benefits.

Other amendments

- ▶ The tax sparing clause, that enabled a Swiss resident to claim a tax sparing credit on interest income under certain circumstances received from Indian sources that were exempted from taxes in India, has been deleted.
- ▶ In relation to the permanent establishment (PE) non-discrimination article, the existing protocol has been amended to provide that a tax rate differential of up to 10 percentage points between a domestic company and a PE of a FE shall not be regarded as discrimination.

Comments

The Swiss Protocol brings about some significant changes to the Swiss DTAA. The amendments, that seek to introduce a specific rule allocating taxing rights on international transportation income, enabling an

automatic trigger of the MFN clause for lower withholding tax rates and removing the ambiguity that is often created on profit attribution to a PE by the reference to 'indirect attribution', are welcome.

With the objective of promoting international cooperation to prevent fiscal evasion, the Swiss Protocol introduces a more effective provision for exchange of information that provides a mechanism for the exchange of banking information as well as information without domestic interest. However, there is no automatic exchange of information, but only in individual cases, where a specific and justified request has been made.

It may be noted that as per the Government's Press Information Bureau (PIB) release, India has also renegotiated its existing DTAA with Australia *vide* a protocol, which was signed on 16 December 2011 (Australia Protocol), but the notification in respect of the same has not been released as yet. As per the PIB release, the Australia Protocol also has an exchange of information article, which has been updated to internationally accepted standards for effective exchange of information on tax matters including bank information and also for exchange of information without domestic tax interest. The Australia Protocol also has a non-discrimination article and provides for mutual assistance between the two countries in respect of revenue claims. Significantly too, it is stated that the Australia Protocol rationalizes the time threshold limits for Source country taxation of PE in certain circumstances (such as for 'service, exploration and equipment PE'), to encourage cross-border movement of capital and services between the two countries.

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