Executive summary

On 7 June 2017, Switzerland and 67 other jurisdictions signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the MLI) during a signing ceremony hosted by the Organisation for Economic Cooperation and Development (OECD) in Paris.¹

At the time of signature, Switzerland submitted a list of 14 tax treaties that it would like to designate as Covered Tax Agreements (CTAs), i.e., tax treaties to be amended through the MLI. Together with the list of CTAs, Switzerland also submitted a provisional list of reservations and notifications (MLI positions) in respect of the various provisions of the MLI. The definitive MLI positions will be provided upon the deposit of its instrument of ratification of the MLI.

Since it has been announced that a public consultation in Switzerland will begin at the end of 2017, entry into force is not anticipated prior to 2019.

Detailed discussion

Background

The text of the MLI and explanatory notes were released on 24 November 2016 as a measure of the OECD’s Base Erosion and Profit Shifting (BEPS) Action Plan (Action 15).²
On 7 June 2017, 68 jurisdictions signed the MLI during a signing ceremony in Paris while eight other jurisdictions expressed their intent to sign the MLI in the near future. Together with the list of CTAs, signatories also submitted a preliminary list of their MLI positions in respect of the various provisions of the MLI. The definitive MLI positions for each jurisdiction will be provided upon the deposit of its instrument of ratification, acceptance or approval of the MLI.

Switzerland’s Covered Tax Agreements

As one of the 68 early signatories, Switzerland has submitted a list of 14 tax treaties that it wishes to designate as CTAs, i.e., to be amended through the MLI. All 14 identified jurisdictions have also signed the MLI and in turn declared their tax treaties with Switzerland as CTAs.

In line with its policy of implementing only the minimum standards of the BEPS Action Plan, Switzerland expressed reservations on the majority of the articles of the MLI. Different from all other signatories, Switzerland made a general reservation that it might choose to implement the BEPS minimum standards by way of bilateral renegotiations of its tax treaties instead of the mechanisms introduced by the MLI.

MLI provisions

Hybrid mismatches

Articles 3 to 5 of the MLI introduce optional provisions aimed at neutralizing certain effects of hybrid mismatch arrangements (BEPS Actions 2 and 6).

Switzerland has reserved the right for Articles 3 (Transparent entities) and 4 (Dual Resident Entities) not to apply to its CTAs. Article 5 includes three options as methods for the elimination of double taxation in the case of hybrid mismatches. Switzerland notified to apply to its residents the switch-over clause (option A). Under the switch-over clause, provisions of a CTA that would otherwise exempt income derived or capital owned by a resident of a Contracting Jurisdiction do not apply where the other Contracting Jurisdiction applies the provisions of the CTA to exempt such income or capital from tax or to limit the rate at which such income or capital may be taxed. Instead, a deduction from tax is allowed subject to certain limitations.

Under option B, Contracting Jurisdictions would not apply the exemption method with respect to dividends if those dividends are deductible in the other Contracting Jurisdiction. Option C includes that the credit method should be restricted to the net taxable income. Contracting Jurisdictions may choose different options resulting in an asymmetrical application of this provision. Switzerland reserved its right not to permit the application of option C to the residents of its CTA Counterparties. This reservation will affect the CTAs with Argentina, Poland and Portugal.

Treaty abuse

Articles 6 to 13 of the MLI contain provisions related to the prevention of treaty abuse (BEPS Action 6). Articles 6 and 7 set out the “minimum standard” aimed at ensuring a minimum level of protection against treaty shopping.

Article 6 – Purpose of a CTA

Article 6 changes the preamble language of a CTA to expressing the common intention to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.

Switzerland did not express any reservations on Article 6 and decided to add optional wording to the preambles of its CTAs, referring to the desire to develop an economic relationship or to enhance cooperation in tax matters.

Article 7 – Prevention of Treaty Abuse

Article 7 articulates the Principal Purpose Test (PPT), a minimum standard which must be adopted by all MLI signatories, and which Parties are allowed to supplement by electing to apply a simplified Limitation on Benefits (LOB) provision in addition.

Switzerland notified the respective provisions in its CTAs but did not make an explicit choice. Thus, the PPT will apply as the minimum standard and default option.

Since Article 7 requires reciprocity between the Contracting Jurisdictions to a CTA, a jurisdiction that opted for the PPT in combination with a simplified LOB (e.g., India) cannot apply the simplified LOB in relation to a CTA that opted for a PPT only (e.g., Switzerland).

Furthermore, Switzerland has reserved the right for Articles 8 to 11 (specific anti-abuse rules on dividend transfer transactions, capital gains, permanent establishment (PE) in third jurisdictions as well as a saving clause to preserve the rights to tax its own residents) not to apply to its CTAs.
Avoidance of PE status
Switzerland has reserved its right not to apply any of the provisions regarding the avoidance of PE status (Articles 12 - 15).

Dispute resolution
Articles 16 and 17 aim to introduce the minimum standards for improving dispute resolution (BEPS Action 14) and a number of complementing best practices.

Article 16 of the MLI requires countries to include in their tax treaties the provisions regarding the Mutual Agreement Procedure (MAP) as described in the OECD Model Tax Convention.

In particular, an agreement reached within the MAP shall be implemented notwithstanding any time limits foreseen by domestic law in the respective jurisdictions. Switzerland reserved its right not to apply this part of Article 16. As an alternative, Switzerland will meet the minimum standards by agreeing in its tax treaties the maximum period of time during which jurisdictions can make adjustments to the profits of domestic taxpayers. The purpose of this provision is to ensure the availability of relief by the MAP.

Article 17 – Corresponding adjustments
This provision is meant to apply in place of or the absence of provisions in CTAs that require a corresponding adjustment where the other treaty party makes a transfer pricing adjustment.

Article 17 of the MLI applies “in place of or in the absence of” an existing provision. Article 17 is not a provision required to meet a minimum standard and therefore jurisdictions can opt out of this article entirely. However, BEPS Action 14 minimum standard requires that jurisdictions provide access to the MAP in transfer pricing cases and implement the resulting mutual agreements regardless of whether the tax treaty contains a provision dealing with corresponding adjustments. In lights of this, a Party may reserve the right not to apply Article 17 of the MLI on the basis that in the absence of a corresponding adjustments provision, either (i) the Party making the reservation will make the corresponding adjustment as described in Article 17 of the MLI or (ii) its competent authority will endeavor to resolve a transfer pricing case under the MAP provision of its tax treaty.

Where one Contracting Jurisdiction to a CTA makes a reservation and notifies a CTA as being within the scope of the reservation but the other Contracting Jurisdiction does not, Article 17 of the MLI will not apply to the CTA.

In the case of Switzerland, its current CTAs with Austria and Italy do not contain a corresponding adjustment provision. Since neither Switzerland nor Austria or Italy made a reservation, the MLI introduces such provision into the Swiss CTAs with Austria respectively Italy.

Switzerland notified the existing provisions on transfer pricing adjustments in its other twelve CTAs, without any reservation. Five Contracting Jurisdictions did also not make a reservation, which means that the corresponding adjustment provision of the MLI replaces the existing provisions of the CTAs between these jurisdictions and Switzerland.

Out of the seven Contracting Jurisdictions who made a reservation, India and Poland did not notify the CTA with Switzerland as being within the scope of the reservation, and hence there is a mismatch in the notifications. Since Article 17 MLI is a provision that applies in place of or in the absence of an existing provision, the MLI provision would still apply to the CTAs with India and Poland to the extent of incompatibility.

Switzerland notified the existing provisions on transfer pricing adjustments in its 14 CTAs; thus, Article 17 of the MLI does not apply.

Mandatory binding arbitration
Articles 18 to 26 of the MLI enable countries to include mandatory binding treaty arbitration (MBTA) in their CTAs in accordance with the special procedures provided by the MLI.

Currently, 25 countries, including Switzerland, have committed to adopting and implementing MBTA in their CTAs.

Switzerland reserves the right to replace the two-year period provided by Article 19 of the MLI to resolve a case by mutual agreement between the competent authorities within a three-year period. Switzerland did not comment on Articles 20 to 23 of the MLI (relating to procedural matters of MBTA), however, an explanatory statement by the OECD on Article 24 of the MLI notes that:
In an arbitration procedure, the “final offer” approach will generally apply. Under this approach, the competent authorities of each jurisdiction submit a proposed resolution to a given case. One of these resolutions will be adopted by an arbitration panel by simple majority. As an alternative, parties may opt for the “independent opinion” approach. Under this approach, each competent authority provides to the arbitration panel any information necessary for the panel to adopt its decision.

Article 24(2) of the MLI allows the competent authorities to depart from the arbitration decision and to agree on a different resolution within three calendar months after the decision has been delivered to them. Switzerland reserves the right to apply Article 24(2), but only with respect to its CTAs for which the above-mentioned “independent opinion” approach applies. The reason for not applying Article 24(2) of the MLI to final offer arbitration is that in such a case, the panel’s decision will be the position of one of the competent authorities and it will, thus, be unlikely that both authorities would agree to depart from the decision.

Implications

In light of Switzerland’s selection of only 14 jurisdictions out of over 90 Swiss tax treaties and of the numerous reservations, the impact of the MLI on Switzerland’s tax treaty network will be limited.

However, the early signature may be interpreted as an expression of Switzerland’s commitment to the BEPS Action Plan. Further, Switzerland’s adoption of the MBTA is evidence of its best efforts to resolve disputes involving other Contracting Jurisdictions as efficiently as possible.

The MLI will enter into force after five jurisdictions have deposited their instrument of ratification. With respect to a specific tax treaty, the measures will only enter into effect after both parties to the treaty have ratified the MLI and a specified time has passed. Given that public consultation is foreseen to begin at the end of 2017, entry into force for Switzerland is anticipated no earlier than 2019.

Endnotes

1. For more background on the global significance of the MLI signature, see EY Global Tax Alert, 68 jurisdictions sign the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS, dated 7 June 2017.

2. See EY Global Tax Alert, OECD releases multilateral instrument to implement treaty related BEPS measures on hybrid mismatch arrangements, treaty abuse, permanent establishment status and dispute resolution, dated 2 December 2016, for a more detailed analysis of the MLI related BEPS measures.

3. Andorra, Argentina, Armenia, Australia, Austria, Belgium, Bulgaria, Burkina Faso, Canada, Chile, China, Colombia, Costa Rica, Croatia, Cyprus, Czech Republic, Denmark, Egypt, Fiji, Finland, France, Gabon, Georgia, Germany, Greece, Guernsey, Hong Kong, Hungary, Iceland, India, Indonesia, Ireland, Isle of Man, Israel, Italy, Japan, Jersey, Korea, Kuwait, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mexico, Monaco, Netherlands, New Zealand, Norway, Pakistan, Poland, Portugal, Romania, Russia, San Marino, Senegal, Serbia, Seychelles, Singapore, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland, Turkey, United Kingdom and Uruguay.

4. For a detailed discussion of the structure and information on the individual provisions, see EY Global Tax Alert, Signing by 68 jurisdictions of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS highlights impacts for business to consider, dated 14 June 2017.

5. Argentina, Austria, Chile, Czech Republic, Iceland, India, Italy, Liechtenstein, Lithuania, Luxembourg, Poland, Portugal, South Africa and Turkey.

6. MLI position of Argentina on Art. 5.

7. MLI position of Poland on Art. 5.

8. MLI position of Portugal on Art. 5.
9. Austria, Liechtenstein, Luxemburg: option A; Chile, Italy, Lithuania: no option; Czech Republic, Iceland, India, South Africa, Turkey: reservation not to apply entire article.


11. Article 16(2) MLI.

12. MLI position of Switzerland on Art. 16.

13. Argentina, Lithuania, Luxembour, Portugal and South Africa.

14. Chile, Iceland, India, Liechtenstein, Poland, Turkey reserved not to apply Article 17 to already existing provisions. Czech Republic will not apply Article 17 MLI directly but renegotiate its DTTs with respect to corresponding adjustments.

15. Andorra, Australia, Austria, Belgium, Canada, Fiji, Finland, France, Germany, Greece, Ireland, Italy, Liechtenstein, Luxembourg, Malta, the Netherlands, New Zealand, Portugal, Singapore, Slovenia, Spain, Sweden, Switzerland and the United Kingdom.

16. Article 19(1) MLI.


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