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LOYENS & LOEFF

Tax Flash

Landmark Swiss supreme court decisions deny withholding tax refund for Danish banks based on lack of beneficial ownership

On 5 May 2015, the Swiss federal supreme court decided two long awaited cases on beneficial ownership. Two Danish banks held fully hedged Swiss equities positions and claimed a refund of Swiss withholding tax on dividends received thereon. According to the court, the Danish banks were not entitled to a refund of Swiss withholding tax as they did not qualify as beneficial owners of the dividends. Consequently, it will be very difficult for financial institutions with pending Swiss withholding tax refund claims associated with supposed dividend arbitrage transactions to receive refunds.

The two Danish banks held Swiss equities on the dividend record date as a hedge for short derivative positions. The banks fully hedged their positions with total return swaps (TRS) and index futures over the same Swiss equities. The Danish banks claimed refund of the 35% Swiss withholding tax on the dividends paid on the Swiss equities based on the (former) tax treaty between Switzerland and Denmark. The latter tax treaty provided for a full refund of Swiss withholding tax. The Swiss federal tax administration denied the refund, arguing that (i) the Danish banks were not the beneficial owners of the dividends as a result of their fully hedged positions and (ii) the transactions constitute treaty abuse. In March and July 2012, the lower court decided in favour of the taxpayers. This court qualified the Danish banks as beneficial owners of the dividends given that the obligation to pass on the dividends received to the counterparties under the derivatives was not conditional on the receipt of the dividends. It also held that there was no treaty abuse as the Danish banks had offices, personnel and business activities in Denmark.

However, in its decisions of 5 May 2015, the Swiss federal supreme court revised the decisions of the lower court, accepting the tax administration's argument that the Danish banks lacked beneficial ownership. In the view of the Swiss

federal supreme court, the concept of beneficial ownership is implicitly included in tax treaties and applies even under (older) treaties that do not contain a specific beneficial ownership provision. The TRS case was decided with a 4-1 vote, the index futures case with a 3-2 vote.

The key elements of the relevant transactions can be summarized as follows. The Danish banks bought the Swiss equities from, and sold them to, brokers. The counterparties to the derivatives were corporate entities residing in the UK, Germany, the USA and France (TRS case) and brokers (index futures case). Apparently, there was no identity between the sellers/buyers of the Swiss equities and the counterparties to the derivatives (no clear evidence of pre-arrangement/ circularity of transactions). The term of the transactions was between 3 and 6 months.

In view of the supreme court decisions of 5 May 2015, it will be very difficult for financial institutions with pending Swiss withholding tax refund claims associated with supposed dividend arbitrage transactions to receive refunds.