

Pakistan, Switzerland Update Tax Treaty

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Pakistan and Switzerland on November 24 exchanged ratification instruments in Islamabad for their new income tax treaty signed on July 19, 2005; the treaty entered into force the same day. (For prior coverage, see *Doc 2008-25042* or *2008 WTD 230-6*.)

The new treaty replaces the 1959 treaty, which was the first treaty concluded by Switzerland with a developing country. The new treaty provisions will be applicable in Switzerland as of January 1, 2009, and in Pakistan as of July 1, 2009.

The new treaty is generally based on the OECD model tax convention and conforms with current Swiss tax treaty policy, except for some minor changes based on the U.N. model.

The new treaty provides for:

- A 10 percent withholding tax in the source country on dividends when the beneficiary is a company holding at least 20 percent of the paying entity. The rate is 20 percent in all other cases.
- A 10 percent withholding at source on interest when the recipient is the beneficial owner of the income. Exceptions are listed in article 11 of the treaty.
- A 10 percent withholding on royalties when the recipient is the beneficial owner of the income. Article 12, section 3 defines royalties as any remuneration paid for the use of a patent, trademark, or industrial design or of industrial, commercial, or scientific equipment.
- A 10 percent withholding at source on the gross amount of technical service fees. The treaty protocol limits the tax rate to 7.5 percent if Switzerland does not levy withholding tax on service fees paid

to nonresidents (as is the case under current law). Also, the basis for the withholding tax, if the costs are proven, is reduced to 80 percent of the gross service fees, which reduces the effective withholding charge to 6 percent.

Article 5 defines a permanent establishment as a construction site or a supervisory activity lasting more than six months. An insurance company that collects premiums or insures a risk in the other contracting state by means other than through an independent insurance broker is qualified as having a PE in that contracting state.

Article 15 (on independent personal services) follows the U.N. model and grants to the state of residence the right to tax any income derived through an independent activity, unless this activity is performed through a fixed place or the service provider spends at least 183 days a year in the other contracting state. In these latter cases, the other contracting state has the right to tax, but taxation is limited to the income derived through such a fixed place or from the activities performed on its territory.

Under article 22, Pakistan applies the credit method to avoid double taxation. Switzerland applies the exemption with progression method, except for dividends, interest, royalties, and technical services fees, which are subject to the Swiss lump sum credit method. Finally, Switzerland offers (on request) a tax sparing credit of 10 percent of the gross amount of Pakistan-source interest income that according to the treaty is exempt from tax at source (that is, typically interest paid on a loan authorized by the Pakistan government within the framework of an investment promotion program). ◆

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