

# Swiss Federal Council Approves South Africa Treaty

by **Thierry Boitelle**

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The Swiss Federal Council on September 7 approved the new double tax treaty with South Africa and submitted it to Parliament for approval and final ratification. The new treaty, signed in Pretoria on May 8, 2007, replaces the outdated treaty of 1967.

South Africa was particularly keen on replacing the 40-year-old treaty because it changed from a territorial to a worldwide tax system in 2001, and as a consequence many of the old treaty provisions had become obsolete.

According to the Swiss Federal Tax Administration, the new treaty is largely compliant with the OECD model and is in conformity with current Swiss treaty policy. Highlighted below are deviations from the model and the current Swiss policy, along with other particulars of the new treaty.

### Withholding Tax Provisions

The new treaty reduces the old withholding tax rates on qualifying parent-subsidiary dividends from 7.5 percent to 5 percent and on interest from 10 percent to 5 percent, and the rate on royalties remains at 0 percent. South Africa currently does not levy withholding tax on dividends but instead applies a "secondary tax on companies" on profits distributed by a South African company to persons resident in South Africa or abroad. The secondary tax is currently 12.5 percent and will be reduced to 10 percent October 1. Furthermore, it is foreseen that the secondary tax will be replaced soon by a proper withholding tax on dividends. Under South African tax law, however, the secondary tax is not a withholding tax on dividends but rather an additional corporate income tax; therefore, it does not fall under article 10 (dividends) of the treaty.

Regarding interest, South Africa does not levy withholding tax on interest paid abroad, and Switzerland does so in exceptional cases only — for

example, on interest paid by banks and interest paid on bonds, similar notes, and other collective debt instruments.

South Africa does levy withholding tax on royalties paid abroad at 20 percent, whereas Switzerland does not levy any withholding on royalties. The new and the old treaty, however, provide for exclusive taxation in the state of the recipient.

### Avoidance of Double Taxation

An important change is that under the new treaty, South Africa (in line with its 2001 domestic tax law changes) no longer has to provide for an exemption, but instead can apply the credit method for the avoidance of double taxation. Thus, the new article 22 will hurt, for example, South African companies operating in Switzerland through a permanent establishment. Those companies will no longer be able to benefit from the generally lower corporate income tax rates in Switzerland on their Swiss business operations. The new treaty does not provide for a grandfathering period allowing taxpayers to restructure their operations. It is not known whether the Swiss treaty negotiators merely ignored this point or simply could not agree on a transition period. Perhaps the Swiss Parliament should consider not ratifying the new treaty before year-end, but rather, for example, in January 2008, so that effectively a one-year grandfathering period is achieved after all.

### Arbitration Clause

A novelty is included in paragraph 5 of article 24 (mutual agreement procedure). This new paragraph 5 contains an arbitration clause that determines that if the competent authorities of the contracting states cannot resolve the difficulties or doubts as to the interpretation or application of the convention

within three years after its initial presentation, the case can — if all means provided by paragraphs 1 to 4 of the mutual agreement procedure have been used — at the request of a contracting state be brought before an arbitral tribunal, provided the taxpayer concerned submits in writing that it will be bound by any final award. The competent authorities will together determine the composition of the arbitral tribunal and the arbitration rules. Some guidance might be found in the 2000 ICC Policy Statement concerning arbitration in tax matters and the 2003 IFA Arbitration Proposal.

Until now, Switzerland has never agreed to any kind of arbitration provision under its bilateral tax treaties. The arbitration clause implies a completely new treaty obligation for the Swiss Confederation, and therefore the new treaty with South Africa has to be submitted for the referendum procedure as per Swiss constitutional law.

### Exchange of Information

Article 25 of the new treaty introduces exchange of information provisions between the contracting states. According to the new article, South Africa and Switzerland will exchange information as is necessary for the application of the provisions of the treaty regarding the taxes it covers; and, upon request, for the administration or application of internal legislation regarding the taxes the treaty covers in the case of tax fraud.

According to paragraph 4 of the protocol (and article 25), tax fraud means fraudulent acts that

constitute a criminal tax offense and are punishable by imprisonment in both contracting states. In the Swiss context, simple tax avoidance does not fall under this definition, but a fraudulent act is deemed to exist when the taxpayer uses, or intends to use, a forged or falsified document and when the taxpayer adopts fraudulent conduct (for example, uses a scheme of lies, a so-called *Lügengebäude*) to deceive the tax authorities.

South Africa is the first non-OECD member state with which Switzerland concluded a new exchange of information provision according to its latest standards, and this may well create a precedent.

### Entry Into Force

The new treaty has been submitted to the competent authorities in both countries for ratification, and theoretically, if the Swiss Parliament sees no objections and no referendum is initiated, its entry into force could be as early as January 1, 2008.

On balance it seems South Africa obtained what it wanted: the credit method replacing the exemption method without a grandfathering provision and a new, more generous exchange of information clause equal to the latest Swiss-OECD model. Unfortunately, it is not entirely clear what Switzerland obtained in return for those concessions. ♦

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