SWITZERLAND – TAIWAN TAX AGREEMENT

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INPUTS AND COMMENTS[1]

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This article aims at presenting some of the salient features of the double taxation agreement entered into by Taiwan and Switzerland. It focuses notably on taxation matters from a cross-border perspective. It examines briefly how royalties, dividends and capital gains are treated. At the same time, it aims at giving a sneak peek into domestic legislation, highlighting factual elements being potentially of interest to investors from one or the other territory. Finally, it points some of the crucial features in relation to the exchange of information.[2]

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New Taiwan – Switzerland Tax Agreement

Context

On December 9, 2011, the Federal Council of Switzerland recognized the private double taxation agreement (hereafter "DTA") entered into by Taiwan and Switzerland. The DTA concluded on October 8, 2007, acquired through the recognition process a generally binding effect for Switzerland. The parties agreed that the DTA shall enter into force on December 13, 2011, with a retroactive effect as of January 1, 2011.

Countries may have numerous reasons to enter into a DTA, but one of the reasons invoked is the perspective to increase mutual foreign direct investment. Consequently, governmental agencies and policy makers increasingly resort to the ratification of double taxation treaties to achieve and stimulate the flow of investments coming from abroad. Furthermore, in an increasingly globalized market, cross-border transactions are constantly increasing and perspectives that revenues generated via such transactions are double-taxed are proportionally correlated.

Taiwan has an economy that has boomed over the last few decades, and is currently ranked by the International Monetary Fund in 21st place worldwide[3]. With a PPP-adjusted GDP per capita of USD 35,700[4], the island is an ever-important trading partner for Switzerland. Indeed, since the 80s, Taiwan entrepreneurs have fully embraced the revolution of new technologies and invested in leading-edge industries. Hi-tech businesses, notably electronics, telecommunications, computers and peripherals are major sectors in Taiwan. Acer, Asus, HTC, ZYxel and D-link are some of Taiwan's most famous technology companies, and B2B companies like Hon Hai and TSMC are industry leaders worldwide. This has supported the need to further strengthen and improve economic ties between Taiwan and Switzerland, offering Taiwanese investors an interesting gateway to Europe and elsewhere, considering that Switzerland has almost 100 tax treaties with other countries. At the same time, this new treaty will further facilitate access to the Taiwan market for Swiss investors.

Key Articles

Only salient features of the DTA at stake will be examined within the following lines, focusing notably on the recurrent cross-border issues arising in practice, such as the taxation of dividends, royalties, interest or the exchange of information. It is also important to mention that, in principle, Switzerland adheres to the OECD Model Convention and this is reflected in the DTA entered into with Taiwan, including most recent developments with regards to the issue of information exchange.

[3] Ranking based on the nominal GDP list of countries for the year 2010 established by the International Monetary Fund in its World Economic Outlook Database-September 2011, International Monetary Fund. Accessed on November 20, 2011.
[4] Index Mundi, CIA World Factbook, estimate for 2010.

Dividends

Dividends can be one way to illustrate the benefits resulting from the conclusion of this DTA. While no withholding tax is imposed on dividends paid by a Taiwan company to a resident shareholder, it is not the case for outbound dividends. As a matter of fact, 20 percent withholding tax is imposed on dividends paid to a nonresident, unless this is reduced by a treaty, which is *de facto*, and for all practical purposes, the case under this DTA. Indeed, article 10 of the DTA provides that dividends paid by a Taiwan resident company to a Swiss shareholder are reduced to 10 percent (instead of the 20 percent Taiwan rate) if the beneficial owner is a Swiss company holding at least 20 percent of the capital of the Taiwan company paying the dividends. In other cases, the Taiwan individual withholding tax is reduced to 15 percent. Consequently, Swiss companies and investors channeling their participation in Taiwan corporations are definitively better off under the DTA. This advantage is even clearer if the situation is reversed and dividends flow from a Swiss corporation to a Taiwan shareholder. Under Swiss law, dividend distributions are subject to withholding tax, no matter whether they are paid to a resident or non-resident shareholder. In other words, before this DTA, Taiwan shareholders were suffering over a tax burden culminating to 35 percent on the dividends paid from Switzerland to Taiwan.

Although the limitation of taxing rights in relation to dividends is an important feature of the DTA, allocating taxing rights between the territory of residence and source, it must be read at the same time with Article 22 of the DTA dealing with the relief from double taxation. In a nutshell, Article 22 of the DTA specifies that the residence territory shall grant relief for the taxes paid in the source territory according to a specific mechanism described below in the section dedicated to the relief mechanism. In other words, although Article 10 of the DTA acknowledges that both territories may tax dividends, this does not necessarily mean that investors will suffer a double tax burden. Indeed, the DTA provides a relief mechanism, helping investors to get an adequate release in their country from the withholding taxes suffered in the country where they are investing. The relief mechanism is not restricted to dividends--it also applies to other forms of cross-border income, including notably those examined in this paper, such as interest, royalties, capital gains, and the others listed in the DTA.

In addition to the direct benefits granted under this DTA, Taiwan entrepreneurs may also consider Switzerland a direct gateway for their companies to the European market. Indeed, it must also be underlined that throughout the ratification of the bilateral conventions between the European Union and Switzerland, which entered into force in 2005, all withholding tax rates in Parent/Subsidiary relationships (provided, however, that the criteria of minimum participation of 10 percent and a holding period of two years are fulfilled) have been reduced to 0 percent.

Interests

Taiwan withholding taxation distinguishes between three different situations. First, Taiwan withholds 10 percent on interest paid to its residents. Secondly, within a cross-border context, the withholding is equal to 15 percent on interest paid to nonresidents on short-term bills, interest on securitized certificates, interest on corporate bonds, government bonds or financial debentures, as well as interest derived from repurchase transactions with the above bonds or certificates. In all other cases the rate reaches 20 percent, unless an agreement on double-taxation provides otherwise. The situation is quite different in Switzerland. Under Swiss domestic law, in principle, no withholding tax is levied on interest. This rule, however, suffers some exceptions, notably when it comes to interest derived from deposits being with Swiss banks, bonds and bond-like loans, which are subject to a 35-percent withholding tax at the federal level. In other words, this means that no withholding is levied on intercompany loans. The 35-percent withholding tax and the tax at source levied under Swiss domestic law can be mitigated under a tax agreement. Article 11 of the DTA provides that under the Taiwan–Swiss Tax Agreement, the tax levied on interest shall not exceed 10 percent, which gives both Taiwan and Swiss investors a reasonable relief within the cross-border context.

Royalties

While Switzerland does not levy a withholding tax on royalties, the situation is not similar in Taiwan. Currently, royalty payments made by a Taiwan entity to a resident are subject to a withholding retention of 10 percent. Before January 1, 2010, the same royalties were subject to a rate 5 percent higher, reaching 15 percent of retention on domestic payments. However, it must be kept in mind that, resident recipients of royalties may ask to offset the tax withheld from their income tax. Unfortunately, the situation is not similar when it comes to outbound royalties. Nonresidents must face a 20 percent withholding perceived by Taiwan on royalties paid abroad, unless the rate is reduced under an applicable tax agreement, which is the case under the current DTA. It provides under Article 12 of the DTA that withholding is capped at 10 percent. In this specific area, Switzerland remains definitively an interesting harbor for Taiwan companies willing to establish their intellectual property holdings in Switzerland. Royalties paid from Switzerland to Taiwan will not be subject at source to a withholding retention.

Finally, Switzerland is a member of the Madrid Protocol and Agreement, providing to trademark owners full access to the system established under the Madrid Union. Switzerland also offers a direct link to European Patents and hosts the World Organization of Intellectual Property. In addition to this, Switzerland provides a highly trained workforce and its universities, notably the Federal Institutes of Technology in Zurich and Lausanne, are consistently ranked as both leading European and worldwide universities. Despite the fact that those are not strictly tax considerations, they need to be carefully considered before incorporating a European seat, especially by hi-tech companies.

Most favored nation clauses in relation to dividends and royalties
It must be pointed out that the protocol ratified by Taiwan and Switzerland with regards to a double taxation agreement between both countries incorporates automatic most-favored-nation clauses in relation to the treatment of dividends and royalties. In substance, these most-favored nation clauses provide that the taxation of dividends and royalties under the DTA between Taiwan and Switzerland shall be accordingly reduced to the rates negotiated by Taiwan with other countries that are members of the OECD. In other words, if an agreement for the avoidance of double taxation or a protocol amending such agreement is signed by Taiwan with a country member of the OECD after the signature of the DTA between Taiwan and Switzerland, and such agreement or protocol exempts the taxation of dividends or royalties or reduces the applicable rate on both passive incomes below 10 per-cent, such exemption or reduction shall automatically apply to the DTA entered into by Taiwan and Switzerland. When it comes to dividends, the exemption or reduction is only applicable if the beneficial owner is a company (other than a partnership) which holds at least 20 percent of the capital of the company paying the dividends.

Capital Gains
Switzerland and Taiwan treat capital gains the same way. Such revenues are not subject in either of the two countries to a specific tax but they fall within the scope of the income tax. More precisely, Switzerland treats capital gains resulting from the sale of assets as ordinary income, no matter how long the assets have been held. In other words, capital gains derived from such sale of assets will be subject in Switzerland to standard income tax and will not suffer any additional levy or extra tax burden, as this might be the case, from time to time, in other jurisdictions. Another interesting feature of the Swiss tax regime that needs to be mentioned is in relation to capital gains. Interestingly, Switzerland considers that capital benefits derived from the sale of participation of at least 10 percent in a resident or nonresident company may qualify for full participation relief if the said participation has been held for more than one year.

Relief from double taxation
The methods for the elimination of double taxation are embedded under Article 22 of the DTA. Since most of the DTA articles dealing with the allocation of taxing rights do not exclude *prima facie* taxing rights in the state of residence, while at the same time, some taxing rights are allocated to the state of source, it is necessary to implement a mechanism granting relief from the double-taxation, which may arise. This is achieved throughout Article 22, which is addressed at the residence territory who shall grant relief from the tax burden suffered abroad. Taiwan adheres to the credit method under this DTA, which means that entrepreneurs from this territory who suffer from double-taxation due to investments in Switzerland may seek relief in Taiwan for the taxes paid abroad. However, the amount to be offset in Taiwan is not infinite. Indeed, the amount of credit shall not exceed the amount of tax which would be due in Taiwan. Switzerland

does not walk along the same path and adheres to the exemption method when it comes to the relief mechanism. However, there is an exception to this general rule, since dividends, interests and royalties are treated slightly differently. Switzerland may also decide to grant relief in relation with these revenues either through a limited deduction mechanism, a lump sum reduction, or a partial exemption scheme.

Exchange of information

Historically, Switzerland had always been reluctant to adopt a provision on the exchange of information, which is laid down in Article 26 of the Organisation for Economic Co-operation and Development (OECD) Model Convention and consequently had maintained for long years a reservation in the OECD Commentary. However, with the growing trend on international transparency, the pressure grew exponentially on Switzerland to abide by these latest developments suggested by the OECD. Consequently, Switzerland had to embrace Article 26 of the OECD Model Convention together with the OECD Commentary. The result is that Switzerland may now have to grant administrative assistance for the collection of information and participate in its exchange.

The DTA ratified between Taiwan and Switzerland adopts the same path. Before the reform of the practice in relation to exchange of information, Switzerland was systematically requiring from the territory applying for the exchange of information to demonstrate that there was a reasonable suspicion that the tax fraud may constitute a criminal offence before cooperating within the context of the exchange of information. Since the modification of the Swiss practice in the field of the exchange of information and as per the DTA ratified by Taiwan and Switzerland, it has abolished the criminal offence link. Consequently the mere fact that the information requested by one state or the other is foreseeably relevant for the tax assessment in the requesting state is now sufficient to solicit the exchange of information under Article 25 of the DTA[5].

While the scope of the exchange of information has been broadened, this does not necessarily mean that treaty partners may use any and all means to get access to the information of the taxpayer. Indeed, under the protocol ratified by both Taiwan and Switzerland in relation to the DTA, it is clearly specified that recourse to the exchange of information is subsidiary by nature, if not to be considered as an "*ultima ratio*". As a matter of fact, treaty partners may have recourse to the exchange of information once all regular sources of information have been exhausted in their respective territories. More importantly, this DTA follows the line drawn by the OECD Commentary which

[5] The DTA between Switzerland and Taiwan does not adhere to the same numbering as developed by the OECD in for its model tax convention. However, Article 25 of the DTA corresponds de facto to Article 26 of the OECD Model Convention, dealing with the exchange of information and cooperation matters.

prohibits “fishing expeditions” and in the present case this is reinforced since both territories have clearly banned such fishing initiatives expeditions through the ratification of the protocol related to the treaty.

Another salient feature of the DTA between Taiwan and Switzerland is that the exchange of information is solely and exclusively available upon request. The parties to the treaty have voluntarily disregarded automatic and spontaneous methods for the exchange of information. It should be clarified that the exchange of information is not guaranteed if one of the treaty partners has only limited information about taxpayers. In fact, in addition to the name of the taxpayer, tax authorities of one of the contracting territories shall also identify the period for which the information is requested, the nature of the information requested, explain why the information is requested and when it is possible to identify the name and address of the person believed to be in possession of the requested information (i.e. whether this is a bank or an independent financial intermediary). Finally, it must also be specified that the DTA between Taiwan and Switzerland embeds a warranty that procedural rules of both countries shall be respected, especially since these are tailored at protecting taxpayers’ rights. Consequently, before any exchange of information is started, the procedural rights of the taxpayers’ in either Taiwan or Switzerland remain applicable, preserving an adequate guarantee that taxpayers will be treated in a fair and equal procedure.

Conclusion

DTA between Taiwan and Switzerland is definitively an important step for both treaty partners. It deepens and strengthens the ties between two important economic players in Asia and Europe. This DTA is also an answer to an ever globalized world, where tax burdens shall not prevent investors from one territory or the other to invest in the other state. Key features of the DTA have been briefly summed up in this paper, however, it is worth again mentioning that in the field of dividends the entry into force of this DTA will bring extra comfort to entrepreneurs and investors, no matter whether they are located in Taiwan or Switzerland. An interesting feature of this treaty is that it may also serve as a gateway to Taiwan investors willing to penetrate the European market, while having a holding company located in Switzerland. While the exchange of information has generated much attention, it can be put forward that the DTA between Taiwan and Switzerland does provide adequate protection to the taxpayer against fishing expeditions or unethical and disputable behaviors adopted by some tax administrations.

Finally, another element which might retain the attention of taxpayers is the existence of the old OECD provision with regards to independent personal services. Indeed, under the current OECD Model Convention Article 14 (independent personal services) has been deleted and the provisions of this article have been embedded into the provisions of Article 7 (Business profits) based on the assumption that the distinction between business and profession has become thin and the commercial atmosphere of modern times has taken away the distinction between the two to a great extent. In substance, although both articles operate in a rather similar way, it must be contended that the principal difference between business profits (Article 7) and independent personal services (Article 14) is that companies cannot perform personal services and therefore this article applies first and foremost to individuals such as independent lawyers, accountants, engineers or architects rendering professional services. In other words, Article 14 of the DTA is the parallel article to Articles 5 and 7 of the OECD Model Convention, but for individuals who provide professional services or other similar activities in a cross-border context; provided that they have a fixed base regularly available there (hotel rooms have been held to create that fixed base if regularly available) they will incur a local tax liability, in respect of those profits which can be allocated to that fixed base.