Spanish Tax Alert

The new Tax Protocol to the Spain-Switzerland Tax Treaty

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1. Introduction

The new Tax Protocol to the Spain-Switzerland Tax Treaty started to be discussed within the Spanish Parliament last February 15th, 2013. This new Protocol initiates a new stage in the international tax relationships between both States, which will be governed by transparency and international cooperation principles and differs from the criteria applicable under the last "Rubik model" agreements signed by Switzerland with other countries, such as the United Kingdom and Austria. The main implications of this new Protocol are: i) it means a substantial erosion and lift of the Swiss bank secrecy; and ii) it includes some technical provisions that affect the structures organized during the last years.

2. Clauses of the (1966) Tax Treaty amended by the (2011) Protocol.

The Protocol introduces the following amendments in certain clauses of the current Spain-Switzerland Tax Treaty (DTT):

- Tax residence clause (article 4 of the DTT): the new wording of the clause includes in the definition of tax resident, covered by the DTT, those pension plans and funds recognized and incorporated in a contracting State in the terms provided in article 10 of the 2011 Protocol.

- Permanent Establishment clause (article 5 of the DTT): this clause is adapted to the OECD Model Convention, by including paragraphs 4f) and 5, which provide for the existence of a permanent establishment when a company established in a contracting State performs its activities in the other Contracting State through an individual duly empowered to conclude and sign contracts on its behalf, except if the said activities are merely auxiliary to the main activities of the company. Notwithstanding the above, the performance of activities in the other contracting State, through an independent agent does not imply the existence of a permanent establishment.

- Dividends clause (article 10 of the DTT): the new Protocol introduces a dividends exemption at source when the following conditions are met:

  — Direct shareholding of, at least, 10%, during a minimum period of one year;

  — Effective taxation (with no exemption) of the company paying the dividend in its Corporate Income Tax;

  — None of the companies can be a tax resident of a third country;

  — Both entities must be corporations.

  Likewise, dividends paid to recognized pensions plans or funds which are residents of a contracting State are exempt from taxation at source.

- Capital gains clause (article 13 of the DTT): the new Protocol introduces paragraph 3 to allow taxation at source of capital gains accrued as a result of the transfer of shares, participations or similar rights of entities having more than 50% of their assets composed by real estate placed in the other contracting State, except if any the following conditions are met:

  — The shares transferred are negotiated in a Spanish or Swiss stock exchange market or any other stock exchange market, as agreed by the competent authorities; or

  — The real estate is affected to the performance of the business activities of the entity whose shares or participations are transferred.

- Double taxation relief provisions (article 23 of the DTT): according to the amendments introduced by the new Protocol:

  — In Spain, the double taxation will be eliminated: i) according to the methods provided in its internal Laws (including the exemption method regulated in articles 21 and 22 of the Refunded Text of the Spanish Corporate Income Tax Law); or ii) applying the ordinary imputation method provided in the DTT, according to the Spanish internal Law.

  The DTT provides for a clause that protects the progressivity.

  The new Protocol eliminates paragraphs 4 and 5 of article 23 of the 1966 DTT, which permitted the application of article 30 of the Refunded Text of the Spanish Corporate Income Tax (deduction to avoid double taxation on Spanish source dividends or capital gains) to foreign subsidiaries, and regulated the tax sparing/matching credit clause for interest.

  — In Switzerland, as a general rule, double taxation will be avoided by applying the exemption method with progressivity, except in the case of Spanish source dividends and royalties, which will benefit from the following methods to avoid double taxation: i) a lump sum of Swiss tax reduction; ii) a deduction resulting from the application of the ordinary imputation method; or iii) a partial exemption in the Swiss tax, equivalent, at least, to the deduction of the tax payable in Spain.

- Mutual Agreement Procedure (article 25 of the DTT): this clause has a new wording in the terms provided in article 25 of the OECD Model Convention and includes an arbitration procedure.

- Exchange of information clause (article 25 bis): the new wording is wholly adapted to the transparency standards provided in article 26 of the (2010) OECD Model.

  Paragraph 12 of the new Protocol establishes several rules with the aim or assuring an effective but proportional exchange of information, trying to avoid "fishing expeditions". In this sense, it is expressly excluded the spontaneous and automatic exchange of information and the inclusion of certain provisions affecting the position of the taxpayers involved in tax proceedings initiated in both contracting States, with regards to the application of the international mutual assistance proceedings. Particularly, the Protocol recognizes the application of the so called participation rights of the taxpayers in the scope of information requirements and provides for the consideration of the time elapsed as from the information request until its receipt by the requesting State, as a justified interruption, in the scope of Spanish tax proceedings. Likewise, the Protocol establishes that the individuals involved in a proceeding in Spain will be not allowed to argue irregularities within the proceedings passed in Switzerland to file an application before the Spanish Courts; it is doubtful that such clause could deploy effects when fundamental guarantees would have been overrided during the proceedings for gathering the data requested.

3. Enforceability of the 2011 Protocol

Generally speaking, the Protocol should be ratified during the year 2013 and, therefore, it should be enforceable as from January 1st, 2014, under the following conditions established in its article 13:

- Regarding taxes withheld at source, the Protocol provisions will apply on the amounts

paid or owed as from the date when the Protocol enters in force;

- Regarding other taxes, the Protocol will apply to the tax years stared as from the date when it enters in force;

- Exchange of information provisions will apply, regarding those taxes regulated in article 2 of the DTT (which includes Personal and Corporate Income Tax and Wealth Tax), to those tax years started as from January 1st, 2010 or to any taxes due for amounts paid or owed as from that date;

  In the case of other taxes, exchange of information provisions will apply to the tax years starting as from the first day of January of the year immediately posterior to the date when the Protocol enters in force or to those taxes due for the amounts paid or owed as from that date.

- The new arbitration clause will apply to those mutual agreement proceedings initiated as from the date when the Protocol enters in force.

The current wording of article 25 bis of the DTT (exchange of information clause) and paragraph IV of the Protocol, as modified by the Protocol dated June 29th, 2006, will be applicable to those cases of tax fraud or equivalent infringement occurred after June 29th, 2006, until the new Protocol is enforceable.