Chapter 4

4.1. Double Taxation Defined

Swiss international tax law aims to limit the number of situations in which income is subject to international double taxation. Within the notion of “international double taxation”, a distinction is to be made between juridical double taxation and economic double taxation.

Economic double taxation exists where more than one person is taxed on the same object. For example, there is economic double taxation when a profit generated by a company is first subject to corporate income tax at the level of the company, and second, taxed as investment income at the level of the shareholder when distributed. This form of double taxation is not necessarily the result of a conflict between two jurisdictions.

Juridical double taxation arises when comparable taxes are levied by two (or more) tax jurisdictions on the same taxpayer in respect of the same taxable income during the same period of time. In particular, international juridical double taxation is the consequence of the three following situations:

1. two States subject the same person to tax on his or her worldwide income (concurrent full tax liability);
2. two States subject the same person, not being a resident of either State, to tax on income derived from one of the two States. This may result, for instance, in the case where a non-resident person has a permanent establishment in one State through which he derives income from another State of which he or she is not a resident (concurrent limited tax liability);
3. a person is a resident of one State and derives income from another State and both States impose tax on that income (concurrent full and limited tax liability).

Swiss domestic law only governs situations of concurrent full and limited tax liability. There are no domestic rules which limit the effects of concurrent full tax liability or concurrent limited tax liability. International tax treaties, on the other hand, govern concurrent full tax liability and concurrent full and limited tax liability.

This chapter concentrates on the different forms of relief from juridical international double taxation. Although the vast majority of Swiss international tax law is devoted to reducing the effects of this type of international double taxation,
there are certain Swiss tax treaties which have special rules to reduce the effects of economic double taxation (See Chapter 3, section III).

4.2. Relief from Concurrent Full Tax Liability

4.2.1. Introduction

There may be situations where an individual or a company is considered by two different States to be resident in each Contracting State. Dual fiscal residence can arise when:

a. the criteria chosen may lead to the existence of dual residence;
b. the States interpret the same criterion differently;
c. two States use different criteria.

This can lead to a problem of international double taxation which is avoided with most countries with which Switzerland has a tax treaty by the introduction of the so-called tie-breaker rules. Tie-breaker rules are a series of criteria which determine in which of the two States the taxpayer is deemed to be resident.

These rules are clearly indicated in Article 4 of the OECD Model Treaty which makes a distinction between individuals and other persons.

4.2.2. Individuals

Article 4, paragraph 2 of the OECD Model Treaty covers the rules applicable to individuals as follows:

“Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

a) he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (center of vital interests);

b) if the State in which he has his center of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;

c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national;
d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement”.

Most Swiss tax treaties follow the OECD Model Treaty in this respect. Preference is therefore given to the Contracting State in which the individual has a permanent home available to him or her. Indeed, residence is the place where the individual possesses a home with some degree of permanency. If the individual has a permanent home in both Contracting States, preference is given to the State with which the personal and economic relations of the individual are closer, this being understood as the center of vital interests. In the case where the residence cannot be determined by reference to this rule, subsidiary criteria are provided; first, habitual abode, and then nationality. If the individual is a national of both States or of neither of them, the question is solved by mutual agreement between the States concerned according to the procedure laid down in Article 25 of the OECD Model Treaty (See Chapter 8).

Article 4 paragraph 2 (a) of the France-Switzerland treaty uses a specific definition of the center of vital interest, in which such a concept is linked with the permanent name.

4.2.3. Other Persons

Article 4, paragraph 3 of the OECD Model Treaty covers the rules applicable to other persons as follows:

“Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident of the State in which its place of effective management is situated”.

The place of effective management concerns companies and bodies of persons other than individuals. Reference is made to the domestic laws of each Contracting State for the criteria used to determine the place of effective management. There may still be a double taxation problem if each Contracting State interprets this notion differently. If this is the case, the question shall be solved by mutual agreement between the States concerned according to the procedure laid down in Article 25 of the OECD Model Treaty (See Chapter 8).

Most Swiss tax treaties include a disposition similar to Article 4, paragraph 3 of the OECD Model Treaty. The Germany-Switzerland tax treaty has the particularity that if a company has dual residency because the place of incorporation is in Switzerland and the effective management is in Germany, the company shall be considered to be a German resident for the purposes of the treaty. However, dividend, interest, royalty and directors’ fees paid from
Switzerland shall remain subject to Swiss income tax (Art. 4, par. 8 Germany-Switzerland tax treaty).

4.3. Relief from Concurrent Limited Tax Liability

There are no rules in international tax treaties which limit the effects of concurrent limited tax liability. This conflict is outside the scope of treaties since, under Article 1 of the OECD Model Treaty, a treaty is only applicable to persons who are residents of one or both of the States.

4.4. Relief from Concurrent Full and Limited Tax Liability

Income received by the resident of one State from another State may often be subject to juridical double taxation. First, it is subject to a tax in the State of source, and second, it is subject to income tax in the State in which the beneficiary is a resident. The following describes the three most commonly used methods of avoiding, or at least alleviating, concurrent full and limited tax liability which are the deduction method, the exemption method and the credit method (A). Special attention has been paid to the Swiss approach (B).

4.4.1. Introduction to commonly used methods

4.4.1.1. Deduction method

As per the deduction method, foreign source income is subject to income tax in the State of residence. However, any taxation levied in the State of source is deducted from the basis of taxation in the State of residence. It is therefore the net income received from the State of source (after tax) that is taxable in the State of residence.