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Revision of the DTA Germany-Switzerland

On 21 August 2023, Switzerland and Germany signed the revision protocol amending the Double Taxation Agreement. The DTA is thus made more OECD- and BEPS-compliant. At the same time, anomalies in this DTA founded in German internal tax law have been maintained, which is regrettable. Nevertheless, some amendments lead to an improvement in legal certainty and practicability.

A. Overview

There is an agreement between Switzerland and Germany for the avoidance of double taxation in the area of taxes on income and wealth (DTA-GER). The DTA-GER is one of the most relevant of the more than 100 DTAs concluded by Switzerland. It dates from 1971 and was last revised in 2010. Prior to the last revision, the Contracting States agreed to revisit the DTA-GER in two stages. At that time, the urgent adjustment of the administrative assistance provision (exchange of information upon request) was implemented. The remaining points in need of revision were postponed until later. This included, in particular, the abolition of the anomalies of the so-called *"überdachende Besteuerung (umbrella taxation)"* and the so-called *"erweiterte beschränkte Steuerpflicht (extended limited tax liability)"* (Art. 4 paras. 3, 4 and 9), which are not contained in any other DTA, as well as the reservation of the domestic anti-abuse provisions (Art. 23), which is also no longer in keeping with the current treaty standards.

The negotiations between the delegations of both states were concluded at the end of 2020 after ten rounds of negotiations and additional technical talks with the initialling of a draft protocol of amendment. In the course of the negotiations, it became clear that the fundamental adjustments demanded by the Swiss side could not be implemented without making unacceptable concessions on other points. Therefore, the delegations agreed on the approach of including those elements in the protocol of amendment that represent a minimum standard of the OECD, or were considered to be in mutual interest.

On the one hand, the protocol of amendment, therefore, implements the OECD minimum standards in accordance with the Multilateral Convention on the Implementation of Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS Convention). On the other hand, the wording of some regulations is aligned with the OECD Model Tax Convention 2017 (OECD-MTC). Finally, various provisions that were previously regulated as so-called consultation agreements between the competent authorities have been transferred to the DTA-GER or its protocol. The last point, in particular, increases legal certainty, as the previous consultation agreements as mere administrative agreements were not considered binding by German courts.

B. Selected significant changes

1. Abuse of agreement; abuse clause

In the newly formulated *preamble to the DTA-GER*, the Contracting States declare their intention not to create opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through abusive arrangements for the purpose of so-called treaty shopping. This corresponds to the trend observed in the recent past to also want to avoid double non-taxation with the double taxation agreements.

The existing Art. 23, para. 1 stipulates that *domestic anti-abuse provisions* are to be taken into account when interpreting the DTA-GER. This becomes relevant, for example, in the case of dividend distributions from a German subsidiary to the (functionally weak) Swiss holding company. Here, the restrictive substance rules of German domestic law often lead to the denial of relief from German dividend withholding tax (anti-treaty shopping rule, § 50d para. 3 German Income Tax Act [EStG]). It is, therefore, not surprising that the German delegation wanted to maintain the previous wording of Art. 23.

In order to ensure OECD conformity nevertheless, a *general anti-avoidance rule (GAAR)* is also introduced in a new para. 3 of the aforementioned provision. Accordingly, DTA advantages are not granted if obtaining these advantages was *one of the main purposes of* the relevant arrangement or transaction. The corresponding standard wording of the OECD-MTC is thus adopted (Art. 23 para. 9 OECD-MTC). In contrast to the provisions of other more recent DTAs of Switzerland, it is not necessary that the *main purpose* of a structure or transaction is to obtain the advantages of the agreement; rather, it is sufficient that one such main purpose exists. However, the GAAR contains – again in conformity with the OECD – an escape clause, which allows counter-evidence that the granting of the advantage is consistent with the objective and purpose of the corresponding DTA provision. In practice, therefore, there should hardly be any different results from the divergent wording.

There is now at least agreement with the German domestic anti-avoidance rule, which in its most recent version also provides for an escape possibility via a principle purpose test (sentence 2 of § 50d para. 3 German Income Tax Act [EStG]). Therefore, if *extra-tax reasons* for an arrangement based on entrepreneurial, organisational, economic or financial aspects demonstrably prevail, the treaty advantages must be granted. It remains to be seen what effects will result in administrative and judicial practice from the application of the domestic and treaty law principle purpose tests.

2. Profit adjustments in the group or between head-office and permanent establishment

Relatively often, profit adjustments at German group companies (so-called primary adjustment) lead to the wish to be able to make a *corresponding adjustment* at the Swiss group company receiving the hidden profit distribution in order to avoid economic double taxation within the group. Double taxation can also arise between the head-office in one Contracting State and the permanent establishment in the other Contracting State from different international tax allocations by the two States. It is, therefore, positive that the protocol of amendment adopts the corresponding provisions from the OECD-MTC, according to which the first taxing state – often Switzerland – is obliged to make a corresponding adjustment (Art. 9 para. 2 and Art. 7 para. 3). However, the corresponding adjustment is not automatic, but only to the extent that the primary adjustment complies with the *arm's length principle*, so that it could also result from a mutual agreement procedure.

The practical advantage of the new regulation is that it makes it unnecessary to go through a mutual agreement procedure in many cases. From a procedural point of view, the new provisions – thus directly from the DTA-GER – may give rise to a *reason for revision* that allows the opening of finally assessed tax periods of the Swiss group company and the implementation of the corresponding adjustment. This eliminates the need to bring about a solution in a mutual agreement procedure only in order to create a ground for revision necessary to implement the corresponding adjustment.

3. Zero-rate for dividends

Dividends from qualified participations of at least 10% of the capital of the dividend debtor are exempt from withholding taxes in both states. The application of this so-called zero rule requires a *minimum holding period of one year*, which was previously defined as a "period of at least 12 months". The amending protocol now clarifies that the time limit is to be calculated to the day and is to be understood as a "duration of 365 days".

Furthermore, the new regulation contains a list of restructuring situations (merger, demerger, conversion), the implementation of which does not result in a new start of the time limit. This corresponds to the previous practice of the FTA, although in individual cases – depending on the particular restructuring – it may still be unclear whether the time limit starts anew or not. In case of doubt, such questions will, therefore, still have to be clarified with the FTA in the future.

4. Mutual agreement procedure and arbitration

In accordance with the standard of the OECD-MTC, the *period of 3 years* for initiating a mutual agreement procedure is now also introduced in the scope of application of the DTA-GER. Thereafter, the application for the initiation of a mutual agreement procedure must be submitted within 3 years of the first notification of the measure of the tax authority deemed to be in breach of the DTA. This deadline makes it necessary, particularly in German-Swiss group relations, to identify possible double taxation at an early stage. It is, therefore, generally advisable to start with the corresponding clarifications already at the stage of the tax audit. In particular, the domestic legal remedies and appeal procedures do not suspend the three-year time limit, so that, if necessary, the two procedural paths must be followed in parallel.

If the mutual agreement procedure does not lead to a settlement, it may be followed by *arbitration proceedings*, which are now subject to a written request by the person who requested the initiation of the mutual agreement procedure (Art. 26 para. 5).

5. Employees and cross-border commuters

The protocol of amendment contains numerous provisions in the area of employment and cross-border commuters, which are inserted into the Protocol to the DTA-GER.

In the case of employees whose wages are apportioned between the countries of activity, Switzerland and Germany, in accordance with Art. 15, para. 1, there is no longer the option of using a flat rate of 240 working days in a year for the apportionment. Rather, the *actual working days* in the relevant period are to be taken into account, and the employer is obliged to *certify* the actual working days and the places of work accordingly.

Taxation as a cross-border commuter requires a regular return from the place of work to the place of residence in the other Contracting State. Until now, a *"regular return"* was assumed if a person went from the place of residence to the place of work and back on at least one day per week or on at least five days per month. According to the new regulation, the employee must commute from the place of residence to the place of work and back on at least 20% of the agreed working days. The new relative rule is intended to take better account of the situation of persons with part-time employments.

6. Public service

A material change is made to the *allocation rule* in the area of cross-border services for public-law entities. The previous link to nationality is no longer applicable and is replaced by the criterion of residence, which corresponds to the requirements of the OECD-MTC. Furthermore, the scope of application of the public service allocation rules is extended to employers organised under civil law who fulfil certain

conditions, including the performance of a public service mission, compliance with certain funding criteria and the existence of state supervision. This amendment takes into account the fact that the Contracting States are increasingly using organisational forms of private law to fulfil their tasks. Various further clarifications in the protocol of amendment, for example, on the demarcation of the public service from entrepreneurial activities of public employers, should increase legal certainty in the application of this allocation rule.

7. OECD minimum tax (Pillar 2)

As a consequence of the treaty-related recommendations of the BEPS Action Plan, the protocol of amendment contains a clarifying note that the exemption of the profits of a permanent establishment in the other Contracting State does not prevent the State of the head-office from levying the supplementary tax under the OECD minimum tax regime (Art. 24 para. 4).

C. Entry into force

Following its signature, the protocol of amendment must be approved by both sides in the legislative process. With the subsequent exchange of the instruments of ratification, the protocol of amendment will enter into force and apply to tax periods from 1 January following the entry into force. It is expected that this will be *1 January 2025*. Deviating from this, the changes in the area of the mutual agreement and arbitration procedures will likely take effect from 1 January 2026.

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