United States – Senate Approves Protocol Amending Tax Treaty with Switzerland

On July 17, 2019, the U.S. Senate voted in favor of ratifying the proposed Protocol between the United States and Switzerland, which was signed by both countries on September 23, 2009. The Protocol contains amendments to the existing income tax treaty between the United States and Switzerland, which was signed in 1996, bringing it into closer conformity with current U.S. and Swiss tax treaty policy. The Protocol makes changes to the treaty provisions concerning cross-border dividend payments, the mutual agreement procedure, and exchange of information between the tax authorities of the respective countries. (For prior coverage, see GMS Flash Alert 2019-107 (June 26, 2019).)

WHY THIS MATTERS

The vote in favor of ratification of the Protocol represents a breaking of the logjam that has prevented new treaties and protocols coming into effect since 2009. The changes introduced by the Protocol could affect international assignees and their employers. The revisions to the exchange of information article provide an additional impetus for assignees to be compliant with the Foreign Account Tax Compliance Act (FATCA) and Foreign Bank and Financial Accounts (FBAR) filing requirements, as the Protocol expands the breadth of information that can be exchanged between the United States and Switzerland. The revisions to the dividends article clarify that both pension plans and individual retirement savings plans established in one of the two countries can be exempt from tax on dividends paid by a company resident in the other country if certain conditions are met.

Entry into Force

The provisions in the Protocol will enter into force upon the exchange of instruments of ratification by the respective countries. However, the date on which the Protocol enters into force is not necessarily the date on which each of its provisions takes effect. The provisions of the Protocol relating to taxes withheld at source (including dividends) for amounts paid or credited on or after January 1 of the year following the date of entry into force. Thus, for example, if instruments of ratification are exchanged before the end of 2019, the withholding rates on dividends paid or credited to...
pension plans or individual retirement accounts on or after January 1, 2020, will be governed by the rules discussed in the next section.

The provisions of the Protocol relating to the exchange of information will apply to requests made on or after the date of entry into force of the Protocol. Requests for information held by financial institutions, nominees, or other entities or individuals acting in an agency or fiduciary capacity can relate to any date on or after September 23, 2009 (the date on which the Protocol was originally signed). In all other situations, information can be exchanged on request if the information relates to tax years beginning on or after January 1, 2010.

Dividends Paid to Pension Plans and Individual Retirement Accounts

Before the Protocol was ratified, individual savings plans, such as individual retirement accounts in the United States and contributory private savings plans in Switzerland, were not eligible to receive the benefits conferred under Paragraph 3 of Article 10 of the original treaty, as these types of plans were not considered pension plans or other retirement arrangements. Article 1 of the new Protocol amends this provision by affording individual retirement savings plans the same rights under Paragraph 3 of Article 10 as pension plans and other retirement arrangements.

The benefits of Paragraph 3 of Article 10 of the Treaty, as amended by the Protocol, can be claimed in relation to dividends paid by a company resident in one country provided (1) the dividend is paid to and beneficially owned by a pension or other retirement arrangement that is a resident of the other country, or an individual retirement savings plan set up in and owned by a resident of the other country; (2) the competent authorities of the two countries agree that the pension or retirement arrangement, or individual retirement savings plan, generally corresponds to such a plan or arrangement recognized for tax purposes in the other country; (3) the pension or retirement arrangement, or individual retirement savings plan, does not control the company paying the dividend; and (4) the pension or retirement arrangement, or individual retirement savings plan, satisfies the requirements of the limitation on benefits article of the treaty (an anti-treaty shopping provision intended to prevent residents of third countries from obtaining benefits under a treaty).3

KPMG NOTE

In 2005, the U.S. Internal Revenue Service (IRS) published the terms of an agreement reached between the United States and Switzerland under the mutual agreement provisions of the treaty in relation to the qualification of certain Swiss and U.S. pension plans for the benefits of Paragraph 3 of Article 10 of the treaty as then in effect.4 It remains to be seen whether the IRS will publish additional guidance on which pension arrangement or individual retirement savings plans qualify for the benefits of Paragraph 3 of Article 10 as amended by the Protocol.

Exchange of Information

Article 3 of the proposed Protocol replaces the Exchange of Information article (Article 26) in the original treaty with one that aligns with current U.S. transparency standards. New Article 26 allows U.S. and Swiss tax authorities to exchange information relevant to carrying out the provisions of the income tax treaty or the domestic tax laws of either country, including information that would otherwise be protected by the bank secrecy laws of either country.5
Dispute Resolution through Mandatory Binding Arbitration

The proposed Protocol amends the treaty provisions concerning the mutual agreement procedure by replacing the optional arbitration provision contained in the original treaty with rules for mandatory and binding arbitration for certain cases about which the competent authorities cannot reach a negotiated agreement. When the competent authorities are unable to reach a complete agreement, the case will be resolved through mandatory and binding arbitration if certain prescribed requirements are met.

FOOTNOTES:

1 The Protocol Amending the Convention between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (the “proposed Protocol”), signed on September 23, 2009, at Washington, as corrected by an exchange of notes effected November 16, 2010, and a related agreement effected by an exchange of notes on September 23, 2009 (Treaty Doc. 112-1). For the vote on this and other Protocols, see the U.S. Senate web page “Roll Call Votes 116th Congress - 1st Session (2019).”

2 See the online version of the Department of the Treasury Technical Explanation of the Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income Signed at Washington on October 2, 1996 and the Protocol Signed at Washington on October 2, 1996, by clicking here.

3 See the Technical Explanation (referenced in footnote 2), at Article 1.

4 IRS Announcement 2005-3.

5 See the Technical Explanation (referenced in footnote 2), at Articles 3 and 4.
The above information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230 as the content of this document is issued for general informational purposes only.

The information contained in this newsletter was submitted by the KPMG International member firm in United States.

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