

Derivatives - Switzerland

Tax decision on total return swaps – how will derivatives market take it?

Contributed by **FRORIEP**

May 20 2015

Facts
Decision
Comment

On May 5 2015 the Federal Supreme Court rendered its long-awaited decision on a withholding tax reimbursement claim related to total return swaps.

Facts

A Danish bank entered into swap contracts with clients in England, France, Germany and the United States. Pursuant to these agreements, the clients undertook to trade the entire return (particularly dividends and capital gain) of a specific underlying asset (in this case, a basket of Swiss shares) against a fixed stream of payments. In consideration of this total return swap, the Danish bank was entitled to a variable interest (London Interbank Offered Rate) and a margin. This allowed the clients to build up a synthetic stake in an underlying asset (basket of Swiss shares) without having to invest directly in the related basket of shares. The Danish bank hedged its obligations arising under the total return swap (ie, payment of the aggregate return at a particular due date) by purchasing the related basket of Swiss shares. Dividends were paid by the Swiss enterprises to the Danish bank net of withholding tax.

Subsequently, the Danish bank sought reimbursement of withholding tax from the Federal Tax Administration of approximately Sfr50 million. The administration denied reimbursement, arguing:

- a lack of beneficial ownership of the dividend on the bank's part; and
- abuse of the double tax treaty between Switzerland and Denmark.

According to the Federal Tax Administration, entering into the total return swap on the one hand and the simultaneous purchase of related shares on the other hand resulted in a transfer of all financial opportunities and risks to the clients. The administration argued that the structure could not be justified on economic grounds and had been purely tax driven.

The administration's decision was appealed and the Federal Administrative Court partly upheld that appeal in March 2012. The court held that the appealing bank had remained free in its decision as to how to hedge its risks. It saw no interdependence between the total return swap and the hedging by the purchase of shares. The court confirmed the bank's beneficial ownership in the dividends and denied treaty abuse.

Decision

The Federal Supreme Court took a different view. It held that the relevant question was whether the bank could freely dispose of the dividends, which it thought was not the case for the Danish bank. The bank did not qualify as an actual recipient of the dividends but merely acted as an interposed entity under legal or economic constraint to pass on dividends to the counterparties of the total return swap. The Federal Supreme Court's written motivation of the decision is yet to be rendered.

Comment

The decision is of great relevance to Swiss and international derivatives markets. There are concerns that underlying values generating returns subject to Swiss withholding tax will no longer be included in total return swap structures. Further consequences for the Swiss and international derivatives markets remain to be seen.

For further information on this topic please contact [Tobias Rohner](#) or [Michael Fischer](#) at FRORIEP by telephone (+41 44 386 6000) or email (mfischer@froriep.ch or trohner@froriep.ch). The FRORIEP website can be accessed at www.froriep.com.

The materials contained on this website are for general information purposes only and are subject to

Authors

Tobias F Rohner



Michael Fischer



the disclaimer.

ILO is a premium online legal update service for major companies and law firms worldwide. In-house corporate counsel and other users of legal services, as well as law firm partners, qualify for a free subscription. Register at www.iloinfo.com.

Online Media Partners



© Copyright 1997-2015
Globe Business Publishing Ltd