

The relief clause of Article 23

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Article 23 is the most unusual provision of the convention and one of the least known. Under the heading "Relief of taxes withheld on dividends, interest and royalties" it subjects the relief under Articles 10, 11 and 12 to specific conditions where a legal person resident in one state is substantially owned by persons not resident in that state.¹ Such a company may claim the reduction of the other state's withholding tax only if five conditions are met. Interest-bearing debts owed to non-residents may not exceed six times the company's equity. The interest on those debts may not exceed the normal rate. At most 50 per cent of the income in question from the other state may be used to satisfy claims of non-residents, such as interest, royalties and similar payments. Expenses connected with that income must be covered exclusively by the income itself. Finally, the company must distribute at least 25 per cent of the income from the other state.²

These conditions reproduce the criteria of the Swiss Federal Council decree of 14 December 1962 against the improper use of tax treaties, which Switzerland applied unilaterally to Swiss companies controlled from abroad. The Italian negotiators accepted them as a reciprocal treaty rule.³ Their practical scope is limited, because they apply only to companies in which non-residents of their state of residence hold a substantial interest and only to income under Articles 10 to 12. Nevertheless they remain in force and can be invoked by the Agenzia delle Entrate against a Swiss holding company owned by non-Swiss persons, for example a Lugano company owned by a Russian, Brazilian or Italian family, that claims the reduction of Italian withholding tax on dividends or royalties. A company that finances itself mainly with shareholder loans, or that passes on more than half of its Italian royalty income to its owners as interest or service fees, may fail the test. Swiss practice under the decree of 1962 and the related circulars of the Federal Tax Administration developed detailed guidance on these ratios. The circular of 17 December 1998 abandoned the old debt ratios for the general unilateral rules, but it expressly left the

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special abuse clauses of the treaties with Belgium, Germany, France and Italy in force, and the circular of 2010 confirms that such treaty clauses prevail over the decree.⁴ Common misconception. Advisers often believe that the abolition of the Swiss anti-abuse decree of 1962 in 2022 removed the conditions on debt financing and distributions from Swiss treaty practice. For the convention with Italy that is not the case. The conditions are written into Article 23 of the treaty itself and continue to bind both states until the treaty is amended. A Lugano holding company owned by non-Swiss residents that claims relief from Italian withholding tax under the convention must still meet the six-to-one debt-equity ratio, the 50 per cent limit on payments to non-residents and the 25 per cent minimum distribution.

1 Notes

1. Convention, Art. 23, title "Sgravio delle imposte riscosse sui dividendi, gli interessi e i canoni", text at <https://www.fiscoetasse.com/files/5715/convenzione-italia-svizzera-del-23121978-943.pdf>; para. 1 refers to a legal person "nella quale persone non residenti di detto Stato hanno un interesse preponderante". ↩
2. Convention, Art. 23 para. 1 lit. a to e, text (above): debts not exceeding "il sestuplo" of equity; interest not exceeding the normal rate; at most "il 50 per cento" of the income used to satisfy claims of non-residents; expenses covered exclusively by that income; distribution of "il 25 per cento, almeno" of that income. ↩
3. Federal Council decree of 14 December 1962 on measures against the improper use of tax treaties of the Confederation (SR 672.202); ESTV, circular "Mesures contre l'utilisation sans cause légitime des conventions conclues par la Confédération en vue d'éviter les doubles impositions" (1962), <https://www.sif.admin.ch/dam/fr/sd-web/p1s0dfyxVySs/kreissschreiben-1962-fr.pdf> (interest-bearing debt above six times capital and open reserves, interest above 5 per cent, more than half of treaty-relieved income to non-entitled persons, distribution of at least 25 per cent); Convention, Art. 23, text (above). ↩

4. ESTV, Kreisschreiben "Massnahmen gegen die ungerechtfertigte Inanspruchnahme von Doppelbesteuerungsabkommen des Bundes" of 17 December 1998, <https://www.sif.admin.ch/dam/de/sd-web/R4ICJdT1Doq6/kreisschreiben-99-de.pdf> (the special abuse provisions of the treaties with Belgium, Germany, France and Italy take precedence; the earlier debt ratio rules no longer applied); ESTV, Kreisschreiben of 1 August 2010, <https://www.sif.admin.ch/dam/de/sd-web/fDBPQXNUcjW/kreisschreiben-2010-massnahmen-dba-de.pdf> (treaty abuse provisions prevail over the BRB 1962). ↩

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