

Swiss Federal Supreme Court on Nexus For Financial Transaction Tax

by Peter Hongler and Ariane Menzer



Peter Hongler



Ariane Menzer

Peter Hongler is a professor of tax law at the University of St. Gallen and counsel at Walder Wyss Ltd. in Zurich, and Ariane Menzer is a research assistant and PhD candidate at the University of St. Gallen.

In this article, the authors examine a recent decision in which the Swiss Federal Supreme Court used a broad definition of intermediary to find a sufficient nexus existed to support the imposition of a securities transfer stamp duty.

Copyright 2021 Peter Hongler and Ariane Menzer. All rights reserved.

Recently, debate regarding international taxation has focused on what constitutes a sufficient nexus to trigger corporate income taxes. However, the nexus question is much broader than that. One of the most extreme forms of a tax nexus was recently confirmed by the Swiss Federal Supreme Court (FSC) and used to justify the application of the Swiss securities transfer stamp duty, a form of financial transfer tax. The case dealt with the purchase of a U.S. target by a Swiss multinational enterprise through a local

U.S. subsidiary.¹ The only connection to Switzerland was the involvement of managers of Swiss group companies in the negotiations of the transaction. This article focuses specifically on the Swiss transfer stamp duty and its impact on transactions involving Swiss-based MNEs, and it also considers what constitutes a reasonable nexus in a broader context.

Background

Overview and Procedural History

A Swiss pharmaceutical group acquired a U.S. company in 2016. After the transaction, the Federal Tax Administration claimed that the transaction incurred a securities transfer stamp duty in the amount of CHF 4,262,848.50 (approximately \$4,693,000).

Article 13[1] of the Federal Stamp Duty Act of June 27, 1973 (SDA), establishes the securities transfer stamp duty, which applies to the transfer of ownership of domestic or foreign securities for consideration when a domestic securities dealer acts as either a contracting party or as an intermediary.² Article 16[1] sets the tax rate at 1.5 per mille (that is, 1.5 per thousand) on remuneration for securities issued by residents and 3 per mille for foreign securities.

According to the Federal Tax Administration, in the transaction at issue, the group parent company triggered the securities transfer stamp duty in its role as an intermediary. The company indisputably qualified as a domestic securities dealer, but its only involvement in the transaction

¹FSC, 2C_638/2020 (Feb. 25, 2021).

²Federal Stamp Duty Act of June 27, 1973 (SDA), SR 641.10. If a securities dealer acts as an intermediary, it owes half the tax (SDA article 17[2][a]).

was the managers' participation in negotiations for the takeover. The acquisition itself was conducted by a local group company in the United States through a reverse merger.

The taxpayer paid the tax under reservation and appealed the Federal Tax Administration's ruling to the Federal Administrative Court³ and then to the FSC. Broadly, the taxpayer argued that the group parent company was not involved in the transaction as an intermediary because the managers' participation in the negotiations did not meet the necessary requirements for the qualification as such.

However, on February 25 the FSC issued a decision confirming the tax authority's assessment and therefore the validity of the authority's claim in the amount of CHF 4,262,848.50.

Facts of the Case

In 2016 a Swiss pharmaceutical group entered into negotiations to acquire a publicly traded U.S. company. For reasons related to U.S. law, a local subsidiary was incorporated to carry out the acquisition. Immediately after the takeover, the new company absorbed the target entity in a reverse merger. The group parent company in Switzerland was not directly involved as a contracting party in those transactions. The final acquisition was carried out by means of a public tender offer and the purchase of a majority of the shares.

The actions of three individuals were particularly important to the court's decision in this case, and they are set forth in consideration 3.2.2.6 of the Federal Administrative Court's ruling and consideration 4.1.3 of the FSC's decision. The FSC attributed these employees to the group parent company, but the company argued that they should be attributed to the group management company (a Swiss company and subsidiary of the group parent company) or the U.S.-based group joint venture company. The three individuals included members of the board of directors and the executive board of the management company and the joint venture. One person was the chair of the group parent

company's board of directors, but it was unclear whether the other two individuals performed similar functions for the parent company. During the relevant period, the chair of the parent company was authorized to sign for all three companies; the other two individuals were only authorized signatories for the management company and the joint venture company. All three people took part in contract negotiations; for example, they participated in phone calls with representatives of the target company and had other contacts with those counterparties. Allegedly, the three individuals decisively drove the contract negotiations by maintaining active contact with the representatives of the target company and making several informal purchase offers.

Findings of Law

Securities Transfer Stamp Duty Generally

According to SDA article 1[1][b], the securities transfer stamp duty is levied on the turnover of some domestic and foreign securities, such as shares or bonds. It is a transaction tax on the transfer of ownership of taxable securities in exchange for consideration. Article 13[1] clarifies that for the duty to apply, a securities dealer must be involved in the transaction either as a contracting party or as an intermediary.

SDA article 13[3][d] states that in addition to banks and some asset managers, domestic companies with assets including more than CHF 10 million in taxable securities are considered securities dealers. Therefore, group parent companies and holding companies often qualify as securities dealers. A securities dealer acts as a contracting party if it issues or sells securities in its own name. In this case, it was undisputed that the group parent company qualified as a securities dealer but was not a party to the contract.

Defining the Intermediary's Role

The main question in the proceeding was whether the group parent company qualified as an intermediary under SDA article 13[1].

The term "intermediary" is used several times in the SDA, but it is not defined in detail. As the FSC explains in consideration 3.2, it used the SDA itself as the primary point of reference for

³ Federal Administrative Court, A-1480/2019 (June 9, 2020).

understanding the term and treated other civil law and economic considerations as secondary.

SDA article 13[3][b][2] states that investment advisers or asset managers are intermediaries, and they qualify as securities dealers. According to consideration 3.2.1, however, the Court explained that the concept of a securities dealer is broader than — and not necessarily limited to — investment advisers or asset managers.

SDA article 17 identifies the persons liable to pay the tax. In this context, the law states that a securities dealer is an intermediary if it settles on original terms with its client, alerts a client to an opportunity to conclude a contract, or acquires and resells securities on the same day. In consideration 3.2.2, the Court concluded that it is unclear whether SDA articles 13[1] and 17[3] are based on the same understanding of intermediary. However, in consideration 3.2.3, the Court also found that the wording of SDA article 17[3][b] — which provides that a securities dealer is an intermediary even if it merely alerts the principal to an opportunity to conclude a contract — seems to be derived from the context of brokerage contracts under civil law.⁴

According to consideration 3.4, on the basis of various indications — including the same functionality (success dependence), historical context, the stamp duty's formal nature, and the wording of SDA article 17[3][b] — the court ruled that an intermediary under SDA article 13[1] should be defined based on the understanding of the term in the civil law of brokerage contracts under the Swiss Civil Code of Obligations article 412 et seq. However, as considerations 3.2.3 and 3.2.4 explain, the existence of a formal brokerage contract in the civil law sense — a contract that would, for example, presuppose a fee — is not a prerequisite. Thus, the FSC disagreed with a scholarly opinion that, referring to the formal nature of the securities transfer stamp duty, argued that an intermediary within the meaning of SDA article 17[3][b] only exists when there is a brokerage contract.

According to Swiss civil law, brokerage contracts involve two kinds of intermediaries: a

broker that only supplies information or an intermediary broker.⁵ A broker that only supplies information is instructed to alert the principal if an opportunity to conclude a contract arises. Thus, the role is limited to the notification of a specific opportunity. Intermediary brokers facilitate the conclusion of a contract. They actively work toward the conclusion of the contract and conduct negotiations on behalf of the contracting party. According to the FSC, in this case, the latter activities were decisive for the qualification as an intermediary.

The FSC stated that besides being remunerated, a characteristic feature of brokerage contracts is their success dependency. The remuneration of a broker presupposes a causal connection between the brokerage activity and the actual conclusion of the contract. In the case of an intermediary broker, there must be at least a psychological connection between the brokerage activity and the actual conclusion of the contract. This means that — directly or indirectly — the broker has consciously influenced the decision to purchase. It is thereby sufficient if the broker's activity was a remote cause of the decision — that is, the decision does not need to be a direct consequence of the broker's actions. A psychological connection exists if, as consideration 3.3 explains, efforts were made that were suitable to have a determining influence on the contracting party.

Attributing Individuals' Actions to a Company

In principle, actions of individuals can be attributed to a company if they actually or apparently held a management function, had an appropriate role in the company's governing body,⁶ or were an associate of the organization,⁷ and they were exercising this function. Thus, having the legal authority to represent the company is not sufficient per se: Authority to sign is only one indication of the power to bind. The decisive question here, as consideration 4.1.2 in the FSC's ruling notes, was whether particular

⁴ See also Federal Act on the Amendment of the Swiss Civil Code (Part Five: The Code of Obligations) of Mar. 30, 1911, SR 220, article 412 et seq.

⁵ Referred to as *Nachweismakler* and *Vermittlungsmakler*. *Id.*

⁶ See Swiss Civil Code of Dec. 10, 1907, SR 210 article 55; CO article 722.

⁷ See CO articles 32-40.

managers involved in the negotiations actually held, or at least appeared to hold, the necessary roles and acted accordingly.

In this case, even though two of the three managers involved in the negotiations were (at least formally) more closely connected to the management or joint venture companies, the court concluded that they were also acting for the group parent company. According to consideration 4.3.1, the court's decision was based on representations in the tender offer, which is referred to in the ruling and in which the managers at least appear to be acting on the parent company's behalf. In the tender offer, reference is made to the parent company on various occasions in connection with the managers.⁸

In connection with the acquisition of the U.S. company, the FSC examined whether the three managers had an influence on the willingness of the target company's shareholders to sell — that is, whether they acted like an intermediary broker. Consideration 4.3 explains that decisive meant there was a psychological connection between the behavior of the individuals and the decision of the shareholders. Further, it is sufficient for the intermediary to consciously influence the decision to sell, directly or indirectly, even if it is only a remote cause. Detailed in consideration 4.3.1, the FSC's assessment of the individuals' behavior focused on the suitability of the conduct to influence the decision to sell. Ultimately, in consideration 4.4, the FSC concluded that the engagement in the contract negotiations was sufficient to qualify the parent company as an intermediary in the sense of SDA article 13[1].

Examining the Nexus Concept

The FSC's decision raises interesting questions from an international law perspective. One of the issues that participants in the ongoing debate about changing the international corporate income tax framework have discussed extensively is what constitutes a sufficient nexus to justify

corporate income taxation.⁹ There is broad agreement that international law requires the existence of a genuine link to a specific jurisdiction to justify prescriptive or substantive jurisdiction.

It is unclear, however, whether the genuine link doctrine is based on customary international law or whether it is a legal precondition of the international law system.¹⁰ This distinction is important because the leeway that states grant may depend on the underlying source of the doctrine. If the genuine link doctrine is based on customary international law, then arguably the rule could develop over time if a sufficient number of states apply the same rule, and there is an *opinio juris sive necessitatis* that the rule should exist. For example, some have argued that controlled foreign corporation rules might be considered a violation of the genuine link doctrine but that the violation is justified if a sufficient number of states apply CFC rules.¹¹ If, however, the genuine link doctrine is a legal precondition in the international law framework, then limiting the scope of application means undermining the international legal system per se. Therefore, that view means there is a core element to the genuine link doctrine that cannot be undermined by developing international customary law. If the genuine link rule is a legal precondition of the international system, then it may be better understood as a normative recommendation about how laws should be drafted rather than as a legal limitation indicating when a state infringes on international law.

Therefore, it is crucial to answer the question of what a genuine link means following both approaches. This requires referring to a specific area of law and determining whether the genuine link is justified in relation to its specific purpose.¹²

⁹ See generally Stjepan Gadžo, *Nexus Requirements for Taxation of Non-Residents' Business Income: A Normative Evaluation in the Context of the Global Economy* (2018).

¹⁰ Compare Gadžo, "The Principle of 'Nexus' or 'Genuine Link' as a Keystone of International Income Tax Law: A Reappraisal," 46(3) *Intertax* 194 (2018), with Peter Hongler, *Justice in International Tax Law: A Normative Review of the International Tax Regime* (2019).

¹¹ See Reuven S. Avi-Yonah, "Does Customary International Tax Law Exist?" Public Law and Legal Theory Research Paper Series Paper No. 640 (July 2019).

¹² See Frederick A. Mann, "The Doctrine of Jurisdiction in International Law," in *Collected Courses of the Hague Academy of International Law* 50 (1964).

⁸ See also Federal Administrative Court, A-1480/2019, cons. 3.6 (June 9, 2020).

There are no general jurisdiction principles in international law because each area of international law must be distinguished; in each individual case, we need to assess whether a link is sufficient to justify granting jurisdiction in a specific regulatory area.¹³ For example, from a tax perspective, what is considered to be sufficient nexus for income tax purposes might not be considered a sufficient nexus for VAT.

Examining the case at hand, the purpose of a securities transfer tax is to tax domestic transactions.¹⁴ Therefore, it is reasonable to conclude that a territorial link — not a personal link — is required. Only if such a territorial link exists can a state have jurisdiction over a transaction. For instance, a transaction that is settled at a domestic stock exchange would seem to have a sufficient nexus for the application of a domestic financial transaction tax.

According to the wording of the law in Switzerland, if a domestic securities dealer is involved either as a party or as an intermediary, it is considered to be a domestic transaction, and the tax applies. *Prima facie*, this seems to be in accordance with international law: It seems

reasonable for the application of a domestic financial transfer tax to apply if a domestic securities dealer is involved. In particular, if applied in a formal sense, the requirement of a domestic party to the transaction prevents too many cases of overlapping tax jurisdiction in cross-border circumstances. The link also seems sufficiently clear to avoid intense disputes. However, the interpretation of the term “intermediary” can make it quite challenging to assess whether a domestic transaction exists, especially if the term is not understood in a formal sense. This has caused the dispute at hand. The only nexus that we have in this case — and the court highlights this point — is a psychological connection between the foreign transaction and the employees of domestic companies in Switzerland. The FSC takes a rather extreme approach in interpreting the genuine link doctrine, but it might still be in line with international law. This also demonstrates a key weakness of the genuine link doctrine: It does not provide clear guidelines regarding what kind of extraterritorial taxation is legally prohibited.

However, its weaknesses notwithstanding, the genuine link doctrine can be helpful for drafting new rules and interpreting existing ones. The latter points to our main point of criticism regarding the decision at hand. The court could have used a different interpretation of intermediary and held that it should be read in a narrower sense to avoid stretching the genuine link doctrine too far. ■

¹³ *Id.* For instance, Mann argues that it would be too far-reaching for Britain to require all of its nationals to sell whiskey at a set minimum price, even beyond its borders.

¹⁴ Swiss Federal Council (Bundesrat), Botschaft des Bundesrates an die Bundesversammlung betreffend den Erlass eines Ausführungsgesetzes zu Art. 41*bis* der Bundesverfassung (Bundesgesetz über die Stempelabgaben), 115 et seq. (May 16, 1917).