



Switzerland and United States exchange of information in tax matters – Where do we stand?

Sonja Maeder*

LALIVE, Geneva
smaeder@lalive.ch

There has been much turmoil in the past year regarding clients of Swiss banks who are US citizens. The United States has indeed become increasingly aggressive towards Swiss banks hosting assets of US citizens which are undeclared in the United States.

On 18 February 2009, with the consent of the FINMA (the Swiss Financial Intermediary Supervisory Authority), UBS entered into a Deferred Prosecution Agreement (the Agreement) with the United States Department of Justice (DoJ) and a Consent Order with the Securities and Exchange Commission ('SEC') whereby UBS agreed to pay the United States a fine and to disclose to the DoJ the identity of approximately 250 American account holders suspected of tax fraud,¹ as well as to produce the related account documents.² The scope of this agreement was to resolve all criminal and most civil issues arising out of the accusations made against UBS. The normal legal assistance proceedings were bypassed in order for UBS to provide these names and the account holders had no chance to oppose the transfer.

Switzerland then entered into another settlement agreement with the United States this time providing that data regarding approximately 4,500 accounts would be transmitted to the Internal Revenue Service ('IRS'). At the same time, Switzerland and the United States started negotiating an amendment to the double taxation agreement between the two States, extending the scope of the exchange of information.

These developments generated a wind of panic not only among US clients of Swiss banks but also within Swiss banks which would no longer accept to host assets of US citizens unless these assets were declared in the United States.

The scope of this article is to clarify where we stand and what will come next.

One shot agreement as a result of the UBS case

On 19 August 2009, UBS and the IRS signed an agreement regarding the pending IRS/UBS case with the objective of ending the cross-border tax dispute between the two parties. On the same day, the United States and Switzerland entered into a settlement agreement on the request for information from the IRS regarding UBS accounts held by US citizens.

The Treaty provides that the United States will submit a request to Switzerland on the basis of the existing double taxation agreement ('DTA') currently in effect between the two States and will withdraw the John Doe summons against UBS demanding disclosure of the identity of 52,000 UBS account-holders and US citizens. In return, the Swiss Federal Tax Administration ('SFTA') will issue final decisions within 360 days of the request being received, on whether the requested information reveals a scheme of 'fraud' or 'continued and serious tax evasion', as defined by the settlement agreement, in a total of 4,450 cases. UBS must make the account information covered by the treaty request available and prepare it for processing by the SFTA.

This settlement agreement was amended with a protocol which was approved by the Swiss Parliament on 17 June 2010. Parliament decided that this settlement agreement would not be subject to a referendum and is now in force.

Under the settlement agreement, UBS had to notify all affected clients who fell within the scope of the IRS request for information, that is, the account holders or beneficial owners of the approximately 4,450 accounts, by the end of May 2010. Therefore, the persons and entities subject to the settlement agreements should now all have been notified.

Based on the information received from UBS, the SFTA examined for each client

relationship if ‘fraud’ or ‘continued and serious tax evasion’, as defined by the settlement agreement, had been committed. If the answer was in the affirmative, the SFTA ruled against the account holder in a final decree that the information shall be disclosed to the IRS. This decision may then have been appealed to Swiss Federal Administrative Court within 30 days of its receipt by the affected party.

The SFTA has finished the process of issuing the final decrees. In some case appeals are still pending.

This settlement agreement can be qualified as a one shot agreement since it concerns a limited amount of bank accounts (4,450) suspected of having hosted assets of persons or entities suspected of having committed tax fraud in the United States and relates solely to accounts held in UBS bank. Furthermore, it appears that all the persons and entities concerned have now been informed.

However, the turmoil created by the UBS dispute as well as other events mentioned below have constrained Switzerland to take long-term steps with respect to its policies in terms of information exchange in tax matters.

Long term revision of cooperation in tax matters

Change of Swiss policies in tax matters

Most of the DTA’s signed by Switzerland – among them the Convention between the United States and Switzerland for the avoidance of double taxation with respect to taxes on income of 2 October 1996 (‘Switzerland/United States DTA’) – are based on the OECD Model Tax Convention on Income and on Capital (‘OECD Model Tax Convention’), which provides for the exchange of information between contracting States in its Article 26.

Switzerland had, however, made reservations to Article 26 of the OECD Model Tax Convention accepting the exchange of information solely in cases of suspicion of tax fraud subject to imprisonment, as defined by both contracting States. This is because Switzerland is very strict in its application of the principle of double criminality. Indeed, pursuant to this principle, the conduct being investigated in the requesting State must also constitute an offence under Swiss law in order for Switzerland to grant mutual judicial assistance.

This reservation has important consequences in the framework of tax matters, since under Swiss law, only tax fraud is a criminal offence. Therefore, until now Switzerland has granted judicial assistance only when the foreign procedure involved elements of an offence tantamount to tax fraud in Switzerland.³

Indeed, Swiss law draws a distinction between tax evasion and tax fraud and only tax fraud is a criminal offence.

Tax evasion, in Switzerland, occurs when a taxpayer fails to submit a tax return or submits an incomplete tax return (eg as a result of false or incomplete entries).⁴ It is generally punishable under Swiss law by a fine and is therefore an infraction rather than a criminal offence under the Swiss Criminal Code. It is a matter for the tax authorities, not for the prosecuting authorities, to pursue cases of tax evasion.

Tax fraud is committed, according to Swiss law, when for the purposes of tax evasion, falsified or non-genuine records, including: accounts, balance sheets or income statements and other statements of third parties, are used to deceive. A tax return is not in itself considered a document. Tax fraud can arise without the falsification of documents where wilful deceit is employed for the purpose of evading tax. For purely domestic purposes tax fraud is the use of forged or falsified documents,⁵ excluding tax declarations. Tax fraud is treated as a crime and is punishable by fine or imprisonment. It is the prosecuting authorities of the respective canton, rather than the tax authorities, which handle these cases.

However, on 13 March 2009, the Swiss Government announced that Switzerland intended to adopt OECD standards on administrative assistance in tax matters in accordance with Article 26 of the OECD Model Tax Convention. This occurred after the G-20 threatened to blacklist Switzerland, which could potentially have led to economic sanctions from the most powerful countries.

Switzerland consequently entered into negotiations on revising its DTA’s in order to extend its cooperation in tax matters to cases of tax evasion.

When entering into these negotiations, the Swiss Government laid out clear conditions for its future policy on administrative assistance in tax matters:



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- respect for established administrative assistance procedures;
- restriction of administrative assistance to individual cases (no fishing expeditions) and rejection of any form of automatic exchange of information;
- fair transitional solutions – no retroactive effect of the amended DTAs;
- limitation to taxes covered by the OECD Model Tax Convention;
- the principle of subsidiarity in accordance with the OECD Model Tax Convention.

On 23 September 2009, Switzerland and the United States signed a protocol amending the Switzerland/ United States DTA (the 'Protocol'). This protocol amends the Switzerland/ United States DTA in the area of tax income and regarding exchange of information in accordance with the OECD standards, in particular with Article 26 of the OECD Model Tax Convention.

The Protocol was approved/ratified by the Swiss Parliament on 18 June 2010 and is still subject to an optional referendum.

Expansion of scope of information exchange with the United States

Pursuant to the Protocol, the Contracting States shall exchange information as may be relevant for carrying out the provisions of the DTA or to the administration or enforcement of the domestic laws concerning taxes covered by the OECD Model Tax Convention (Article 3 paragraph 1 of the Protocol).

The exchange of information is no longer limited to cases of tax fraud, as was the case until now under the Protocol. It is now sufficient that the information is necessary to the administration or enforcement of the domestic laws concerning taxes. Switzerland will therefore no longer be able to legitimately oppose requests of information based on the Swiss bank secrecy, as was the case until now.

Indeed, the Protocol expressly provides that the requested State may not decline to supply information solely because a bank or other financial institution holds the information. Furthermore, the Protocol directly empowers the tax authorities of the requested State to enforce the disclosure of information, notwithstanding any contrary provisions in its domestic laws (Article 3 paragraph 5 of the Protocol).

The exchange of information is, however, limited to the taxes provided for under the DTA (Article 3 of the Protocol).

Finally, the person about whom the information is requested does not have to be a resident of a contracting State; an economic link with one of the contracting States is sufficient.⁶

No fishing expedition

As mentioned above, Switzerland has declared that it would exchange information in tax matters only in individual cases and upon specific request.

This is reflected in the Protocol which provides that the exchange of information would take place upon request of one of the parties.

Indeed, Article 4 of the Protocol provides that when making a request for information, the requesting State shall provide:

- i) information sufficient to identify the person under examination or investigation;
- ii) the period of time for which the information is requested;
- iii) a statement of the information sought including its nature and the form in which the requesting State wishes to receive the information from the requested State;
- iv) the tax purpose for which the information is sought; and
- v) the name and, to the extent known, the address of any person believed to be in possession of the requested information.

The last condition is necessary and is in particular relevant when banking information is requested. The requesting State will have to provide bank details to support its request and cannot ask the requested authority to search in any bank whether a specific person has accounts.

Information will therefore be provided only upon specific and detailed request.

No retroactivity

During the negotiation of the Protocol, the United States insisted on the amended agreement having an unlimited retroactive effect or, at least, until 1 January 2009. Switzerland, however, rejected this request and the parties finally agreed that the Protocol would be applicable to information as provided for under Article 26 paragraph 5 of the OECD Model Tax Convention (information held by a bank or other financial institutions) that relates to any date beginning on or after the date of signature of

this Protocol, that is 23 September 2009.

Indeed, Article 5 of the Protocol provides that the provisions shall have effect in respect of exchange of information, to requests made on or after the date of entry into force of this Protocol i) regarding information described in paragraph 5 of Article 26 of the Convention, to information that relates to any date beginning on or after the date of signature of this Protocol; and ii) in all other cases, to information that relates to taxable periods beginning on or after the first day of January of the year following the date of signature of this Protocol.

Data obtained illegally

The Swiss Parliament in its decision to approve the Protocol added one further condition to the exchange of information in the framework of the amended DTA. This condition is that Switzerland will not grant mutual legal assistance in tax matters when the request is based on data obtained illegally.⁷ This is in particular relevant when the requesting State obtained the initial information in breach of Swiss banking secrecy.

Conclusion

The settlement agreement regarding the UBS dispute has shown that Swiss banks are no longer untouchable. According to some rumours, the bank Credit Suisse would now be in the line of sight of the IRS. However,

it rather appears that the UBS settlement agreement was a one shot agreement which will have no long term effect and is limited to a certain number of clients of only one bank who are suspected of having committed tax fraud or continued and serious tax evasion.

The Protocol amending the Switzerland/United States DTA will, however, have a long-term effect and will be unrestricted in terms of sources of information (not restricted to one bank) and no tax offence will be a prerequisite to the exchange of information. The only limitation is that it will only apply to taxes provided for under the Switzerland/United States DTA and that it will have no retroactive effect.

For a long time, Switzerland was often considered as a safe haven for tax evasion, however, the new Swiss policies in the framework of exchange of information in tax matters have clearly put an end to this conception.

Notes

- 1 The 250 American clients' names were selected by UBS pursuant to a list of criteria established by the FINMA. See www.finma.ch/e/aktuell/pages/mm-ubs-xborder-20090218.aspx.
- 2 See www.ubs.com/1/e/about/news/archive/archive10?newsId=162297.
- 3 Swiss Federal Supreme Court decision ATF 115 Ib 68.
- 4 See 'The Basis for International Mutual Legal and Administrative Assistance', available at: www.eda.admin.ch/eda/e/home/foreign/ecopo/chfin/ehap4.html.
- 5 Article 186 Federal Income Tax Act ('FITA').
- 6 Message of Swiss Federal Council FF 2010, 222
- 7 Decision of Parliament – *Arrêté fédéral portant approbation du protocole modifiant la Convention entre la Suisse et les Etats-Unis d'Amérique contre les doubles impositions*, 18 June 2010 (Article 3)