



TERRALEX
Your Global Source for Business Lawyers

Mobile version

Login New User

HOME ABOUT US MEETINGS & EVENTS LAW FIRM SEARCH PRACTICE GROUPS PUBLICATIONS HELP

Newsletter - TerraLex Connections

Switzerland: Varying Standards in the Exchange of Information in Tax Matters in the Wake of UBS Case and the German Taxation Agreements

 Mail it!  Print it!

By Dr Simone Nadelhofer and Sandrine Giroud¹

I. Introduction

"*Banking secrecy remains intact.*" These were the often quoted words of the Swiss Finance Minister in the spring of 2009 following the handover of the names and account information of 285 US citizens holding (undeclared) accounts with UBS in Switzerland. Further to the *UBS* case, the Swiss banking system has faced increasing international pressure to soften its standards for the exchange of information in tax matters. At the same time, judicial proceedings have been filed abroad against holders of Swiss accounts based on tax data stolen by former employees of Swiss banks.

These recent developments have reshaped the Swiss banking secrecy in varying degrees and given rise to several legislative changes. This article aims at providing an overview of recent changes of rules implementing Switzerland's new policy towards exchange of information in tax matters.

II. Swiss Standards for the Exchange of Information in Tax Matters

Foreign States can use two channels to obtain tax-related information on holders of Swiss bank accounts from Switzerland: administrative assistance and mutual legal assistance in criminal matters.

When foreign tax authorities are involved, the exchange of information is carried out by means of *administrative assistance* within the legal framework of bilateral double taxation agreements ("DTAs"). Alternatively, in the case of criminal proceedings, information can be exchanged by way of *mutual legal assistance in criminal matters* ("MLA") based on multi- and bilateral mutual legal assistance agreements or, additionally, in accordance with the Federal Act on International Mutual Assistance in Criminal Matters (the "IMAC").

Administrative assistance proceedings are, as a rule, more rapid and less formal than MLA proceedings. Furthermore, evidence collected in Switzerland under MLA proceedings may only be used for the purpose of the criminal investigation for which assistance has been granted (the so-called "principle of speciality"). As a consequence, any direct or indirect use of the documents and information obtained for any other purpose, notably of taxation in the requesting State is prohibited and is subject to explicit and prior authorisation by the competent Swiss authorities. By contrast, administrative assistance, which is based on DTAs, typically contains a much broader definition of the principle of speciality. Accordingly, information may be disclosed to any third parties or authorities involved in the assessment, collection, or administration of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by the DTA.

III. The Special Case of the US: The Aftermath of the UBS Case

Switzerland's policy on the exchange of information has been reshaped by the *UBS* case. The American endeavours to obtain information about US taxpayers holding bank accounts with UBS has put Swiss banking secrecy rules to the test and gave rise to ground-breaking decisions which were subsequently crystallised in a bilateral instrument.

The original – and still current – legal basis for the exchange of information between the two States is to be found in the 1996 double taxation treaty ("DTA 96"). A new DTA reflecting the full scope of Article 26 of the OECD Model Tax Convention was signed on 23 September 2009 by both the US and Swiss Governments ("DTA 09"), which statutorily extends the scope of information exchange to cases of tax evasion. This instrument is, however, still pending ratification by the US Senate, the Swiss parliament having approved it in spring 2011. Until then, the DTA 96 still remains applicable.

Whereas the DTA 96 allows for legal assistance in cases of suspected "tax fraud and the like", the DTA 09 "officially" extends the scope of the exchange of information to cases of "tax evasion". In practice, however, Switzerland had already relaxed its strict information exchange policy towards the US by agreeing to provide treaty assistance in approximately 4,200 cases of continued and serious tax evasion concerning UBS through a separate bilateral treaty dated 19 August 2009 and its amending protocol of 31 March 2010. This instrument had been signed by the Swiss Government with the objective of putting an end to the UBS cross border tax dispute and was ratified by the Swiss parliament in June 2010. It is noteworthy that this agreement does not settle US claims against other Swiss banks, such as Credit Suisse.

As regards the formal requirements of treaty requests, the Swiss government had stressed that the exchange of information under the DTA 09 would be limited to individual cases where a specific and justified request has been made. In particular, an account holder name was to be the key prerequisite for granting legal assistance under the DTA 09.

In a much criticised decision of 5 March 2009, the Swiss Federal Administrative Court ("SFAC") considered, however, that group applications, *i.e.*, administrative assistance requests based on "behavioural patterns" of a group of persons were admissible under the DTA 96. In particular, the SFAC held that it was irrelevant whether or not the investigating tax authorities could already name those taxpayers who may have committed tax offenses. The SFAC has considered that the mere reasons to suspect that tax offenses had been committed by third parties based on the description of "a general pattern of facts and circumstances" were a sufficient basis to grant a request for information exchange.²

In the light of this interpretation of the DTA 96, it seems unlikely that Switzerland will be able to continue excluding group requests from the scope of the DTA 09. This will be all the more difficult given the recent threat of new tax probes against ten Swiss banks (in particular Credit Suisse) launched by the US tax authorities. The Swiss government reacted by formally inviting Parliament, in August 2011, to approve additions to the DTA 09 allowing for administrative assistance requests based on behavioural patterns, as admissible under the DTA 96. The Swiss parliament has postponed its decision until its winter session in December 2011.

IV. Exchange of Information Based on OECD Friendly Double Taxation Agreements

A. OECD Standard on the Exchange of Tax-related Information

In the wake of the *UBS* case and growing international pressure, Switzerland decided in March 2009 to adopt the OECD standard on the exchange of information, as set out in the OECD Model Tax Convention, and to withdraw its reservation to Article 26.

The OECD Model Tax Convention provides, *inter alia*, for a system of administrative assistance among tax authorities of the signatory countries. It does not directly apply to individual cases but is merely a model text that can be used as a basis for DTAs as negotiated and signed by the relevant countries.

Pursuant to Article 26 of the OECD Model Tax Convention, States shall exchange information that is foreseeably relevant to the correct application of a tax convention as well as for purposes of the administration and enforcement of "domestic tax laws" of the contracting States upon specific request. Switzerland's former reservation meant that it could ignore other States' domestic law criminalising "tax evasion", an act not prohibited under Swiss law and thus not giving rise to an exchange of information. Under the traditional Swiss concept, "tax evasion" includes cases where a taxpayer intentionally or negligently fails to pay tax, whereas "tax fraud" implies an additional fraudulent element such as the use of forged or falsified documents (*e.g.*, balance sheets, accounts, income statements and other statements of third parties) by the tax fraudster.

By withdrawing its reservation to Article 26, Switzerland has waived its former distinction between "tax fraud" and "tax evasion" and will therefore grant request of information exchange in cases of

assistance sought for alleged cases of tax evasion where DTA's have been renegotiated accordingly. The greater scope for exchange of information only comes into effect when the renegotiated agreement enters into force. To date, Switzerland has adopted or renegotiated over 35 Article 26-friendly DTAs.³

Further to this concession, the Swiss government has declared that Switzerland will seek to enforce stricter requirements to avoid fishing expeditions, thus prohibiting random and indiscriminate searches. Accordingly, information shall only be provided upon receipt of a substantiated written request from a foreign State, with an adequate description of the incriminated facts including the name of the taxable person and the bank or branch in question.⁴ In the meanwhile, and in consideration of the Swiss government's fear of being again black or grey listed by the OECD, this seemingly strict information access policy has, however, been relaxed to allow a request to be based on the indication of a bank account number only.⁵

Since March 2009, Switzerland has entered into several DTAs with an administrative assistance clause in accordance with the OECD standard. The administrative assistance clause in the DTAs contains the substantive legal basis for the exchange of information with the contracting States, the procedural implementation of which has to be ensured under national law.

B. The Tax Administrative Assistance Act

The procedural implementation of the OECD compliant administrative assistance procedure is subject to national law. To this end, Switzerland will introduce a new Tax Administrative Assistance Act ("TAAC") governing the terms and conditions for the execution of administrative assistance in accordance with the OECD standard.⁶

The draft TAAC presented by the Swiss government in early July 2011 confirms the general principle that administrative assistance will be provided exclusively upon request in individual cases, ruling out group applications. However, in line with further concessions towards the OECD, the draft TAAC provides that whereas a request for assistance should ideally contain the name and address of not only the taxpayer but also the holder of the information (e.g., a bank), other means of identification, such as the identification via a bank account, would be admissible. Special agreements to the contrary (e.g., as with the US) remain reserved.⁷

Furthermore, it is explicitly stated that a request will not be considered if it is based on information that was obtained by acts that are punishable under Swiss law, such as the illegal acquisition of data ("*fruit of the poisonous tree*" doctrine). From a Swiss point of view, the question of stolen banking data is very sensitive. Notably, in 2009 a former employee of HSBC Geneva stole client data that were handed over to the French authorities. Also, stolen Swiss bank data that were contained in several CDs purchased by German authorities were passed on to other countries. Based on such experiences, Switzerland has decided that no exchange of information will be granted in case of stolen bank data.

This position has already been criticised by the OECD Global Forum on Transparency. Paradoxically, several Swiss cantons had themselves relied on illegally obtained data received from the German criminal authorities, to prosecute Swiss tax fraudsters, a practice which had been protected by the Swiss Federal Supreme Court ("SFSC") in a judgment of 2 October 2007.⁸

The draft TAAC further sets out from whom and how the requested information is to be obtained, who is to be informed of the pending request, and who has a right of participation and appeal. It is noteworthy that Swiss tax authorities may request the owner of the information (typically the bank) to invite the person entitled to appeal domiciled abroad to designate, within a certain deadline, an authorised recipient in Switzerland. Subject to the requesting State's permission, the Swiss tax authority may also inform the person domiciled abroad directly.

After having collected the information requested by the foreign State, the competent Swiss tax authority, the Federal Tax Administration ("FTA"), will issue a formal decision, subject to appeal to the SFTA.⁹ Note that the appeal deadline envisaged is only of 10 days upon receipt of the final decision concerning the exchange of information. As a rule, the appeal has suspensive effect, meaning that no information will be handed over to the requesting State before the final decree comes into force. In the appeal, various arguments can be envisaged such as the lack of specification of the request and its "fishing expedition" nature, the lack of relevancy of the information requested, the existence of obvious errors, contradictions or omissions in the request, or the fact that the request is based on illegally obtained data.

Client data information will be only transmitted to the requesting State if the taxpayer has exhausted all administrative procedural rules, in particular the appeal procedure. Moreover, bank information transmitted abroad may only be used to enforce Swiss tax law to the extent that it could have been obtained in accordance with Swiss law.

The draft TAAC will not only cover administrative assistance in the framework of DTAs but will also govern administrative assistance based on other agreements which provide for the exchange of information relating to tax matters, e.g., the agreement on the taxation of savings income with the EU.

V. The Final Withholding Tax Model and its German and UK Implementations

A. The Final Withholding Tax Model

The recent developments faced by Switzerland in relation to its bank secrecy and tax system have shown the need, for the sake of legal certainty, to implement a new model of exchange of information in tax matters to regulate these issues in a general and consistent manner. In this perspective, Switzerland has been negotiating a Final Withholding Tax ("FWT") model with various States since the beginning of 2011.

The FWT model offers the opportunity (a) to finally settle the income tax due on previously undisclosed investment incomes and (b) to provide a mechanism which preserves anonymity. In doing so, Switzerland aims at maintaining the guarantee of the bank secrecy, whilst complying with legitimate foreign tax claims. This aims also at solving the problem of illegally acquired tax data regarding clients of Swiss banks, such as those acquired by Germany or France.

The FWT model works on the basis of a FWT levied by a Swiss Paying Agent (e.g., banks, securities dealers and other natural and legal persons), which is then transferred anonymously to the tax authorities which transfer it to the competent foreign authorities. The FWT is calculated at a flat rate and applies, *inter alia*, to interest, dividends and other investment income. The FWT is levied on natural persons and any constructs associated with these persons (e.g., domiciliary companies, foundations, or trusts).

Only a model, the FWT needs to be negotiated with each State and anchored in a bilateral agreement. The implementation and specification of each of these agreements will be further set out in the Federal Act on International Withholding Tax ("IWTA"). Currently a draft submitted to consultation, the IWTA contains provisions on the organisation, procedure, judicial channels and criminal sanctions which are provided under the tax agreements based on the FWT system, such as the German and the UK tax agreements. In particular, the draft IWTA sets out the enhanced exchange of information system provided by these agreements.

B. The German and UK Agreements: Key Points

In line with the FWT model developed by Switzerland, bilateral tax agreements were signed with Germany on 21 September 2011 and with the UK on 6 October 2011. These agreements still need to be approved by each country's parliament and their entry into force is foreseen for early 2013. Their temporal scope, however, will cover already assets deposited in Switzerland on 31 December 2010.

Pursuant to these agreements, residents of Germany or the UK will be able to retrospectively tax their existing banking relationships in Switzerland either by making a one-off tax payment to the German, respectively the UK, tax authorities or by disclosing their account (regularisation of the past). The agreements will also regulate the taxation of future investment income and capital gains by way of a withholding tax (future taxation).

The content of these agreements are essentially the same save for certain differences due primarily to the different tax systems. Their key points are the following:

Identification: The agreements will apply to all "relevant persons" and "relevant assets".

In a nutshell, "relevant persons" are:

- any individual resident in Germany or the UK, who as a contractual partner of a Swiss Paying Agent, is the account holder or deposit holder and beneficial owner of assets;
- any beneficial owner, as so determined by the Swiss Paying Agent in line with the prevailing Swiss due diligence obligations and taking into consideration all the circumstances known to it, who holds assets via various legal vehicles. Such legal vehicles comprise domiciliary companies, *i.e.*, legal entities, companies, institutions, foundations, trusts, fiduciary companies and other establishments not exercising a trading or manufacturing activity or another form of commercial operations. However, a German or UK resident is not considered to be a "relevant person" with regard to assets of associations of persons, asset structures, trusts or foundations, if it is not possible to ascertain the beneficial ownership of such assets, e.g., due to the discretionary nature of the arrangement. Given the margin of appreciation, this distinction promises to be the subject of future legal battles;

- non-UK domiciled individuals are also covered by the Swiss/UK agreement unless they can prove by way of certification by a lawyer or tax agent that they have complied with certain conditions.

“Relevant assets” comprise all forms of bankable assets booked or deposited with a Swiss Paying Agent (e.g., cash accounts, precious metals accounts, stocks, shares, securities, structured products), but not the contents of safe deposit boxes, real estate, chattels or insurance contracts.

Regularisation of the Past: German and UK resident taxpayers with undeclared Swiss funds are left with three main options:

- **Anonymous one-off payment and clearance of tax liabilities:** Taxpayers will accordingly pay a one-off flat rate tax ranging between 19% and 34% depending on the duration of the client relationship as well as the initial and final amount of the capital. In particular, the rate will be inversely proportional to the time during which the assets remained in Switzerland. The one-off payment will be determined on the basis of a complex formula set out in each respective agreement and will satisfy interest and penalties with respect to the covered tax liabilities. Note that if there are insufficient funds with the Swiss Paying Agent to pay the one-time payment on the due date, there are rules for granting an 8 weeks grace period, then disclosing the individual's identity to competent tax authorities.
- **Voluntary disclosure:** Alternatively, taxpayers who do not want to incur the levy in Switzerland can disclose their banking relationship in Switzerland to the German, respectively UK authorities. Disclosure means that the relevant person will be the subject of retrospective taxation by its tax authorities on an individual basis.
- **Closing of Swiss account:** Finally, taxpayers who are unwilling to resort to any of these options must close their accounts in Switzerland within 5 months of the entry into force of the relevant agreement, failing which the corresponding (one-off) tax will be automatically deducted from their assets.

The one-off payment is, however, not applicable in cases where, *inter alia*, the tax affairs of a “relevant person” with “relevant assets” are under investigation, where a person was contacted personally to participate in a disclosure facility, where the assets are derived from the proceeds of crime, or where the assets derived from the proceeds of non-tax crime and certain systemic tax fraud crimes.

While the agreements cannot prevent taxpayers from closing their account before the entry into force of the agreements, Switzerland has undertaken to provide German and UK authorities with statistical information on the 10 most important destination countries where funds of such account holders have been transferred.

Under these agreements, Swiss institutions are also committed to making an upfront payment to German, respectively UK, tax authorities in the amount of CHF 2 billion for Germany and CHF 500 million for the UK, within a month after the entry into force of the agreement. These amounts will be offset by the one-off payments and thereby reimbursed to the banks.

Withholding Tax for Future Taxation: After the entry into force of the agreements, German or UK taxpayers' holder of a Swiss account will have two options in order to become tax-compliant:

- **Anonymous payment of a withholding tax:** A taxpayer can submit to an anonymous withholding tax payment levied on income and gains. The uniform tax rate will be of 26,375% for German taxpayers and between 27% and 48% for UK taxpayers, depending on the category of capital income;
- **Voluntary reporting:** Alternatively, a taxpayer can make a voluntary report to his respective tax authorities.

C. Enhanced System of Exchange of Information

The FWT system, as implemented in the German and UK agreements, provide for an enhanced system of exchange of information which is regulated differently from the draft TAAC. In exchange the issue of illegally acquired tax data is resolved.

In view of preventing the deposit of new untaxed assets by taxpayers who have regularised their situation under the FWT mechanism, German, respectively UK, authorities are allowed, under certain conditions, to request information as to whether the taxpayer concerned held or holds an account or a safekeeping account with a Swiss Paying Agent, without specifying which Swiss institution holds its assets.

Such request is only allowed in the light of plausible grounds for verifying the accuracy and completeness of the information regarding the taxpayer in question. Such grounds exist where the foreign tax authority has identified on a case-by-case basis a tax risk in relation to one of its taxpayers and sees plausible, non-arbitrary grounds for checking his tax position. These grounds shall be based on an analysis of a range of information such as previous tax returns, level of income, third party information and knowledge of the persons who were involved in completing a tax return. Fishing expeditions are, however, still prohibited.

Following a request the Swiss authorities will investigate the existence of accounts and deposits through a general request to Swiss banks which will be obliged to disclose the existence of accounts and deposits of the named individual. The Swiss authorities shall inform the foreign taxpayer before the information is transmitted about the intended exchange of information. He may appeal against the intended exchange of information to the extent provided by Swiss law.

Such information requests are limited in number. German authorities are allowed to make between 750 and 990 such requests during an initial period of 2 years, while UK authorities are allowed to obtain information regarding up to 500 named persons per year between 2013 and 2016. These numbers are subject to subsequent amendments.

VI. Conclusion

The UBS case and the OECD pressure have reshaped the Swiss standard for the exchange of tax-related information and Switzerland is now taking active steps to set the basis for a long-term settlement of the issue of undeclared tax assets.

This implied adoption of the OECD standard on the exchange of information and its incorporation in renegotiated DTAs. Moving one step further, Switzerland is now establishing a FWT model based on a withholding tax levied at source at a flat rate and transferred to the tax authorities of the requesting States. While allowing for the possibility to preserve anonymity of holders of Swiss bank accounts, these new DTA's ensure the implementation of legitimate foreign tax claims and a quasi-automatic exchange of tax-related information. This should put an end to the use of illegally acquired data but also shelter banks and their employees from criminal prosecution.

The new legal regime applicable to the exchange of information in tax matters depends largely on the content and outcome of bilateral negotiations. The best option available to each taxpayer will essentially depend on an individual's circumstances, in particular the period during which the bank account has been open, the origin of the funds and the fluctuation of the funds since their deposit.

These developments will enhance legal certainty and should strengthen the reputation of Switzerland as a financial centre. Yet, numerous uncertainties remain which will call for judicial decisions. Legal guidance will be crucial to navigate in such uncharted waters.

¹Both attorneys-at-law with LALIVE. They can be reached at snadelhofer@lalive.ch and sgiroud@lalive.ch

²SFAC decision of March 5, 2009, in: ASA 77 (2009) p. 837 ff.

³Such DTAs have been signed with: Austria, Canada, Colombia, Denmark, Finland, France, Germany, Greece, Hong Kong, India, Ireland, Japan, Kazakhstan, Luxembourg, Malta, Mexico, the Netherlands, Norway, Oman, Peru, Poland, Portugal, Qatar, the Republic of Korea, Romania, Russia, Singapore, Slovakia, Spain, Sweden, Turkey, the United Arab Emirates, the United Kingdom, and the United States.

⁴This requirement has to be seen in relation to the requests for administrative assistance lodged by the US Internal Revenue Service (IRS)'s to the Swiss authorities in the context of the UBS

Settlement. These requests were at the vanguard of tax information sharing insofar as the IRS requested information about a group of unknown and unidentified clients based on behavioral patterns, which was considered admissible by the Swiss Federal Administrative Court under the then applicable US-Swiss DTA.

⁵See the news release available at: <http://www.efd.admin.ch/aktuell/medieninformation/00462/index.html?lang=en&msg-id=37645%3C/p%3E> (11 November 2011).

⁶The new Act shall replace the current Ordinance on the Provision of Administrative Assistance in Accordance with DTAs which was adopted on 1 October 2010.

⁷Article 1(1) and 6(2) TAAC.

⁸Decision of the SFSC ATF 2C_514/2007 of 2 October 2007 (the *Baltliner* case).

⁹The decision of the SFTA may be further appealed before the SFSC if the proceedings raise a question of principle.

Posted: Monday, December 05, 2011

Topics: Administrative Law, Taxation, Banking

Copyright 2009, TerraLex, Inc. - All rights reserved. TerraLex "The Worldwide Network of Independent Law Firms," and the globe logo are registered trademarks of TerraLex, Inc. "Global Expertise. Local Connections. Seamless Service." , and the trade dress of the TerraLex website are trademarks of TerraLex, Inc.