Exchange of Information

Switzerland's Position Evolves Over Time

Brussels May 25, 2000

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A. The Traditional Exchange of Information Provisions

1. General Remarks

According to Art. 26 (1) of the OECD Model Convention the competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Convention or of the domestic laws of the Contracting States concerning taxes covered by the Convention insofar as the taxation thereunder is not contrary to the Convention.

Switzerland has issued a reservation on Art. 26 of the OECD Model Convention. It will propose to limit the scope of this Article to information which is necessary to carry out the provisions of the Convention.

Switzerland's negative attitude on providing information which may only be relevant with respect to the other Contracting States' domestic tax laws, has led to a distinction between administrative assistance and legal assistance. In its Treaties Switzerland will provide administrative assistance, it will not, however provide any legal assistance.

In order to understand Switzerland's traditional position with respect to the difference between administrative assistance and legal assistance it is important to draw (according to Swiss law) a distinction between

(i) tax avoidance

(ii) tax evasion

(iii) tax fraud

Tax avoidance implies an unusual transaction aimed at achieving tax savings.

Tax evasion is generally limited to individuals who do not properly declare their income.

Tax fraud implies the use of forged or falsified documents and is thus predominately a corporate matter.

2. Administrative Assistance under the Belgian-Swiss Treaty

The Treaty with Belgian is almost 25 years old and hence amongst the oldest Swiss treaties. According to Art. 26 of the Belgian Treaty exchange of information in tax matters is strictly limited to what is necessary for the proper application of the Treaty and it does therefore not include the implementation of any domestic laws.

It moreover contains a provision according to which any exchange of information is not possible where such exchange would violate business or banking secrecy provisions.

The information exchanged under the Belgian Treaty can not go beyond an **administrative report** issued by the Federal Tax Administration.

3. Administrative Assistance under the Old U.S. Treaty

i) Authority Competent

Federal Tax Administration.

ii) Scope

In general: only information which was necessary for carrying out the provisions of the convention, i.e. information which was relevant with respect to the proper application of the Treaty such as e.g. the levy of withholding taxes.

If somebody did not invoke the Treaty (at all) no information was exchanged between Switzerland and said person's country of residence.

The only exception was made with respect of information in cases of "**fraud and the like**"**,** which information was applicable with respect to the implementation of purely domestic U.S. laws.

The 1951 Treaty did not, however, define what was meant by „fraud and the like".

iii) Form

Administrative assistance could not go beyond an administrative report issued by the federal tax administration.

4. International Legal Assistance

i) Source of Law

Federal Act on International Mutual Assistance in Criminal Matters, dated March 20, 1981 („**IMAC**").

ii) Authority Competent

Federal Police Department ("*Bundesamt für Polizeiwesen*")

iii) Requirements

- Dual Incrimination ("*beidseitige Strafbarkeit, d.h. Rechtsverletzung gleicher Art")*
- Limited use of evidence supplied by Switzerland *("Spezialität der Rechtshilfe*"). Evidence delivered by Switzerland in connection with legal assistance shall only be used in the context for which it has been asked for. If legal assistance is granted in tax matters such evidence shall only be used in connection with a tax matter, not however with respect to any other crime which may have been committed by the taxpayer in question.
- In order for Switzerland to grant legal assistance it is not necessary that the facts are being proven, it is enough if the facts are leading to the conclusion that a crime may have been committed[1].

  In cases of **fiscal fraud** ("Abgabebetrug") documents can be supplied and witnesses can be heard. Legal assistance does not however involve the extradition of either Swiss or foreign citizens to any foreign country.

[1] Es muss kein strikter Beweis des Tatbestandes erfolgen; es genügen hinreichende Vedachtsmomente, damit dem Gesuch entsprochen werden kann. Hinzu kommt, dass eine blosse Beweisausforschung verboten ist" => BGE 115 Ib 68ff, E 3 bbb on page 78.

iv) Scope

For purely domestic, i.e., internal Swiss purposes a tax fraud ("*Steuerbetrug*") necessarily involves the use of **forged or falsified documents**.[2]

The tax declaration as such is not a document.

For international purposes the definition of **fiscal fraud** as provided in Art. 14 (2) VStrR ("*Verwaltungsstrafrecht*", Federal Law on Criminal Acts in Administrative Matters „**CAAM**") applies:

From the leading cases[3] it appears that fiscal fraud pursuant to the CAAM and the IMAC may not only be committed when a taxpayer uses, or has the intention to use, forged or falsified documents, but also other types of fraudulent deceit ("*absichtliche Täuschung*") may also qualify as a fiscal fraud,, such as the use of a scheme of lies ("*Lügengebäude*"). The latter cases will only amount to a fiscal fraud, however, if the funds flow either directly or indirectly back to the taxpayer who was engaged in a fraudulent deceit.[4]

v) Banking Secrecy

Bank secrecy will not be upheld in cases in which international legal assistance will be granted.

For the time being there is no piercing of the banking secrecy in the context of administrative assistance.

5. Administrative Assistance under the New Swiss Treaty with the U.S.

i) Authority Competent

Federal Tax Administration

ii) Scope

The basic principle, according to which administrative assistance relates to what is necessary for carrying out the provisions of the treaty remains unchanged.

Administrative assistance can, however, also be used for the **prevention of tax fraud or the like** *("für die Verhütung von Betrugsdelikten")* in relation to the taxes covered by the new Convention. The term „prevention" is new and has not received any further explanation in either the Protocol or the Memorandum of Understanding. The term prevention implies that it does not refer to tax fraud which has occurred but to tax fraud which is about to occur at some future date.

Administrative assistance can only be given with respect to taxes covered by the treaty. While this will cover most taxes, it will not apply with respect to any State

[2] Art. 186 Federal Income Tax Act ("**FITA**").
[3] BGE 111 Ib 242ff. and 115 Ib 68ff.
[4] „*direkter oder indirekter Kapitalrückfluss*" pursuant to BGE 111 IB 250.

taxes or to VAT, social security and other important taxes not covered by the treaty.

Administrative assistance will also be granted in cases of tax fraud. The term „tax fraud“ ("Abgabebetrug“) has now been defined in Article 10 of the Protocol. Tax fraud includes:

- „Forged or falsified documents“ ("Urkundenfälschung“), and in particular „incomplete financial statements“, or
- a scheme of lies to deceive the tax authorities, or
- (as Article 10 the protocol illustrates but without the intention to limit the application of tax fraud) any act which is intended to fraudulently deceive the tax authorities ("*absichtliche Täuschung der Steuerbehörden*“)[5].

iii) Form

Administrative Assistance is no longer restricted to an administrative report, but will now also include authenticated copies of unedited original records or documents.

iv) Limited Use of Evidence Supplied by Switzerland ("*Spezialität der Amtshilfe*“)

The new treaty sets forth a limitation in the use of information obtained through administrative assistance. Any such information shall be treated secret and shall only be disclosed to persons or authorities involved in the assessment, collection or administration of, the enforcement and prosecution in respect of taxes covered by the Convention.

v) Banking Secrecy

It was a firm requirement from the U.S. side that administrative assistance allows, if need there is, to pierce banking secrecy.

The new treaty provides (as already the 1951 treaty did) that no information shall be exchanged which would disclose any trade, business, industrial or professional secret or any trade secret. According to Swiss views banking secrecy is a professional secrecy which is part of this non-disclosure list.

The Memorandum of Understanding refers to the banking secrecy and confirms the mutual understanding between the two governments, that in cases of tax fraud (as defined by the 1996 treaty) banking secrecy does not hinder the gathering of documentary evidence from banks.

The main difference between the 1951 and the 1996 treaty is that banking secrecy can thus be pierced, without recurring to the complicated provisions of the IMAC. **In cases of tax fraud (as defined under the 1996 treaty), administrative assistance is enough to pierce the banking secrecy.**

[5] As set forth in BGE 115 Ib 68ff.

B. New Dimensions of an Old Issue

1. General Outlook

With the exception of the exchange of information provision set forth in the new Treaty with the U.S., Switzerland was able to maintain it's restricted exchange of information policy without undergoing any major changes. Treaty partners by and large have accepted Switzerland's position. The only notable exception is Italy which refrains from applying agreed upon treaty provisions by putting Switzerland on its black list, thus unlawfully impeding any reasonable trade and commerce from Italy to Switzerland. This negative Italian attitude has prevailed for the last 20 years.

Exchange of information has until recently been a predominately bilateral matter as in each treaty an exchange of information clause had to be agreed upon. In the last two years, the exchange of information has, however, been in the focus of the U.S., the OECD and EU.

Three events helped to have the exchange of information issue become a tax matter with multinational dimensions.

- The new U.S. withholding tax regime which will be effective January 1, 2001,
- the OECD report on banking information, and
- the EU's proposal for a Taxation of Savings Directive.

2. QI-Regime

i) Background

One of the most significant changes under the new U.S. tax regulations is the requirement for U.S. withholding agents to obtain **beneficial owner documentation** before reducing the 30% U.S withholding tax rate on dividends and interest or, in some cases, the 31% domestic backup withholding tax.

The 30% withholding tax is imposed under the U.S. tax regime applicable to income derived from "fixed determinable annual payments" ("**FDAP**") to foreign persons (sometimes referred to as "NRA" withholding, where "NRA" stands for "nonresident alien".

The 31% percent backup withholding tax is imposed under U.S. regime applicable to payments to certain U.S. (or presumed) taxpayers.

ii) The Basket Regime

Despite the complicated regulatory setup the U.S. and the Swiss tax authorities agreed on a simple and pragmatic manner in which they wish to implement the new U.S. system. There will be a **four basket regime** in the context of which "U.S. Persons" fall into a special category which has to identify itself by using U.S. **Form W9**. To my knowledge such form has not been officially released as yet.

Non U.S. persons will fall into either one of three possible baskets:

- Swiss resident customers who wish to apply for the lower treaty rate.
- Foreign residents of a treaty country who wish to apply the lower treaty rate. In this context the QI will have to know the applicable foreign treaty rates.
- Foreign residents who are residents of non treaty countries and residents of treaty countries who do not wish to apply the lower treaty rate.

iii) Know-Your-Customer Rules

The advantage of the Swiss system is the replacement of the U.S. W8-Forms by the Swiss Know-Your-Customer Rules. These are rules which are voluntarily being adhered to by all Swiss banks even though they are not in any way legally binding.

The rules impose the verification of the beneficial owner and use for this purpose a special **Form A** If Form A will disclose a U.S. person as the beneficial owner of the funds deposited on a particular bank account the Swiss bank will have to ask for a Form W9.

If the beneficial owner has not filed form W9 on or before December 31, 2000, any U.S. securities held by such person will be subject to backup withholding starting as of January 1, 2001.

If the U.S. person refuses to sign Form W9 before December 31, 2001, the Swiss bank will have to discontinue doing U.S. business with said person, i.e. to acquire, hold or sell any U.S. securities.

iv) The QI-Agreement

The new U.S. system has far reaching consequences for a foreign "Qualified Intermediary" ("**QI"**), i.e. a foreign bank which is qualified to act as a foreign withholding agent under the new U.S. regime.

A QI will have to enter into an QI-Agreement with the Internal Revenue Service. Such QI-Agreement ("**QIA**") can not be negotiated with the IRS or unilaterally changed by a QI in any manner, it just can either be signed or not.

The QIA describes the function of the QI and imposes a strict regime on how to handle U.S. Persons. The QI will be subject to verifications by an independent auditor regarding the manner in which U.S. Persons were handled.

3. The OECD Report on Access to Bank Information

i) Background

In April 2000 the OECD finally published its Report on Improving Access to Bank Information for Tax Purposes. The report has the purpose of considering ways to improve international co-operation with respect to the exchange of information in the possession of banks and other financial institutions for tax purposes.

The main aims of the Report are to describe the current position of Member Countries as to the access to bank information and to suggest measures to improve access to bank information.

The Report acknowledges that some countries are of the view that, while they recognise the interest of tax authorities in improving access to bank information they would have great difficulties at the present stage to grant tax authorities free access to such information. The Report does however also recognise that the international climate has changed with respect to access to bank information for tax purposes. There appears to be a growing recognition of the importance of bank information not only to combat non-tax criminal activity and money laundering but also to **combat tax crimes**.

ii) Measures Suggested

The Report encourages Member countries to

- undertake the necessary measures to prevent financial institutions from maintaining anonymous accounts and to require the identification of their usual or occasional customers as well as those persons to whose benefit a bank account is opened or a transaction is carried out.

- re-examine any domestic tax interest requirement that prevents their tax authorities from obtaining and providing to a treaty partner, in the context of a specific request, information they are otherwise able to obtain for domestic tax purposes.

- re-examine policies and practices that do not permit tax authorities to have access to bank information, directly or indirectly, for purposes of exchanging such information in tax cases involving intentional conduct which is subject to criminal tax prosecution with a view of making changes, if necessary to their laws, regulations and administrative practices.

The Report indicates that these measures do not in any way diminish the importance of bank secrecy as a fundamental requirement of any sound banking system. In connection with these measures countries should examine their laws regulations and practices and make modifications if necessary to ensure that taxpayer information obtained from banks is adequately protected from wrongful disclosure or inappropriate use.

iii) Swiss Considerations

The report recognises bank secrecy. The Report moreover deals with the issue of "double incrimination". That is, says the Report, before assistance can be provided to a requesting country, it must be established that the conduct being investigated would constitute a crime under the laws of the requested country if it occurred in the requested country.

One the very basic principles of the IMAC has thus been recognised by the OECD. The Report points out, however, that a "double incrimination" standard in the tax area can significantly hinder an effective exchange of information between treaty partners on criminal matters. This means that all OECD countries must use a comparable definition of a tax crime, as otherwise such exchange can not take place. The report thus indicates that the Committee will undertake further work on examining the definition of tax fraud in different countries and in moving towards a common understanding of this concept.

It must now be evaluated whether the Swiss standard of "fiscal fraud" corresponds to a generally acceptable definition of fiscal crime or whether it must be reviewed. The problem is that by lowering the standard Switzerland uses in international relations, it will contradict equally high standards used for purely internal purposes.

A further satisfaction for Switzerland lies in the fact that the Report integrates the limited use of tax information standard embedded in the IMAC, as it asks for an adequate protection of taxpayer information obtained from banks.

4. EU Tax Savings Directive

i) Background

As part of the 1997 Monti-Package the EU country are presently considering whether it should be introducing a special tax regime with respect to certain interest payments which EU residents may be receiving on foreign bank accounts.

On the taxation of savings, the ECOFIN conclusions noted that: "To ensure a minimum of effective taxation of savings income within the Community and to prevent undesirable distortion of competition, the Council calls upon the Commission to present a proposal for a Directive on the taxation of savings".

The Commission did release such proposal by giving Member Countries the choice between imposing a 20% withholding tax on interest payments or by exchanging information with the recipient's country of residence.

Unlike double taxation treaties which allow the source country to impose a withholding tax, in the case of the Taxation of Savings Directive such tax will be imposed on the paying agent.

The paying agency regime is vigorously opposed by the UK because the UK acts as the paying agent of most eurobonds issued by U.S. borrowers. If the Taxation of Savings Directive would be implemented in its present form and if the UK were to choose the withholding rather than the exchange of information alternative, all Eurobonds issued by U.S. borrowers would become subject to tax, despite the fact,

that the IRC contains special provisions allowing for the tax exempt payment on such bonds[6].

This in mind the UK has now decided that it will opt for **the exchange of information alternative**. As such choice implies that the Eurobonds will not be subject to any withholding, the question arises whether "withholding" is still a viable alternative under the existing proposal for a Taxation of Savings Directive or whether a new savings directive must be drafted.

ii) Swiss Implications

The very weakness of the paying agency withholding regime lies in the fact that it can easily be circumvented if payments flow through an agent who is not a resident of an EU Member State.

Assuming that the withholding regime would be imposed in the EU, the U.S. may decide to henceforth use Switzerland rather than London as a country where the paying agents reside. In order to avoid any such turmoil on the financial markets, the Swiss Federal Council has issued repeated statements indicating that it would change its laws in accordance with the changes which would be imposed in connection with the EU Taxation of Savings Directive.

These statements were however made at a time when it appeared that most EU Member States would be opting for a withholding tax system. Should the EU countries follow the British initiative and implement an EU wide improved exchange of information system, Switzerland will obviously have to review its alignment policy. For the time being it is, however, premature to speculate on what the ultimate outcome of the Monti package and of the Taxation of Savings Directive might be.

[6] Sec. 871 (h) IRC.