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Implementation of the new FATF Recommendations in Switzerland

Qualified tax crimes as new predicate offence / Consequences for financial intermediaries

Background and FATF Recommendations

In February 2012, the Financial Action Task Force **(FATF)** revised and amended its international standards for combating money laundering and terrorist financing. As a FATF member, Switzerland subsequently approved the 40 revised FATF Recommendations and has since been implementing them into Swiss law. In this context, on 12 December 2014, the Swiss parliament has adopted the new “Implementation of the 2012 Revised FATF Recommendations Act”.

This new federal act provides for the following key amendments to various existing laws (Swiss Code of Obligations, Swiss Criminal Code **(SCC)**, anti-money laundering-regulations, etc.):

1. higher transparency of legal entities, i.e. the ultimate beneficial owner of a legal entity may only be an individual (not another legal entity), and the individual(s) owning bearer shares and controlling bearer/registered shares must be put on record by registering with a (non public) company share register to be set up for this purpose by the issuing company (or with a special register held by a financial intermediary);

2. strict identification of the ultimate beneficial owner (risk-based approach, extensive documentation);

3. qualified tax crimes as predicate offence to money laundering (see below);

4. broadening of the term “PEP” (politically exposed person) to Swiss PEPs and PEPs of supra-national organizations;

5. cash payments for the purchase of movable and immovable assets in excess of CHF 100’000 require the involvement of a financial intermediary and/or compliance with anti-money laundering regulation (i.e. documentation);

6. the Money Laundering Reporting Office Switzerland **(MROS)** shall have increased powers in case of reporting of a suspicious transaction (right to share financial information with financial intelligence units abroad, to request information from other Swiss authorities or financial intermediaries, freezing of assets shall only be initiated upon MROS' request and not automatically upon reporting);

7. improvement and tightening of financial sanctions related to financing of terrorism and terrorists.

These statutory amendments will affect a broad range of subjects beyond the mere financial intermediaries, such as for instance companies issuing bearer shares, beneficial owners of at least 25% of the shares - be it bearer or registered shares - in a company as well as recipients of substantial cash payments (e.g. merchants such as jewelers, art dealers, etc.). Hence, the implementation of the FATF Recommendations is bound to have a broad impact.

This newsletter, however, focusses on the changes to art. 305^{bis} para. 1^{bis} and art. 305^{ter} SCC and the fact that qualified tax crimes shall be considered as predicate offence to money laundering, on the one hand, and on the new exchange of information rules affecting financial intermediaries in particular, on the other hand.

SCC amendments: qualified tax crimes as predicate offence to money laundering

FATF Recommendation Nr. 3 stipulates that countries should apply the crime of money laundering to all serious offences, with a view to including the widest range of predicate offences. Consequently, qualified tax crimes shall constitute a predicate offence to money laundering. The FAFT Recommendation, however, does not provide for a definition of qualified tax crime. Rather, it is left to the individual member countries to specify and create appropriate categories of qualified tax crimes in their domestic legislation.

The aforementioned FATF Recommendation however specifies that a predicate offence may be described by reference to either (i) all tax offences, (ii) a threshold linked to a category of serious offences, (iii) the penalty of imprisonment applicable to the predicate offence (threshold approach), (iv) a list of predicate offences, or a combination of these approaches. It also states that, whichever approach is adopted, each country should at least include a range of offences within each of the designated categories. The money laundering offence has to be extended to any type of assets, regardless of their value, that directly or indirectly constitute the proceeds of a crime. Furthermore, the predicate offence for money laundering should also include crimes committed in other countries, where it is considered in the same manner, i.e. also constitutes a predicate offence to money laundering.

In Switzerland, criminal law legislation defines qualified crimes as "felonies" ("crimini", "crimes" or "Verbrechen") (art. 10 para. 2 SCC), whereas felonies differ from "misdemeanors" ("reati", "offenses" or "Vergehen") based on the associated sanction. Indeed, felonies are sanctioned by a prison sentence of more than 3 years, whilst misdemeanors will result in a prison sentence of below 3 years or in a simple fine. As of today, tax offenses are not regarded as felonies under Swiss law. Indeed, tax fraud is defined in art. 186 of the Federal Direct Taxes Act **(FDTA)** and art. 59 para. 1 of the Harmonization of the Cantons and Councils Direct Taxes Act **(HDTA)** and is classified as a "misdemeanor". This is due to the fact that the prison sentence for committing tax fraud is less than 3 years and, as such, not sufficient for the Swiss tax fraud to qualify as a qualified tax crime. In application of art. 186 FDTA and art. 59 par. 1 HDTA, any person who uses falsified or altered documents for the purpose of misleading the tax authorities and committing tax evasion will be sanctioned with a prison sentence or a fine that shall not exceed CHF 30'000. The use of such kinds of altered or falsified documents qualifies as a "behavioural' offence".

In order to fulfill the requirements of the FATF Recommendations, the Swiss legislator therefore introduced a new provision to art. 305bis SCC (see below) pursuant to which tax fraud, as defined in art. 186 FDTA and art. 59 para. 1 HDTA, will now under certain circumstances be considered as a qualified tax crime and thus constitute a predicate offence to money laundering.

The new language of art. 305bis SCC shall be as follows **(in bold)**:

> ***„Art. 305bis***
>
> *Money laundering*
>
> *1. Any person who carries out an act that is aimed at frustrating the identification of the origin, the tracing or the forfeiture of assets which he knows or must assume originate from a felony,* ***or from a qualified fiscal crime*** *is liable to a custodial sentence not exceeding three years or to a monetary penalty.*
>
> ***^{1}bis. Are considered as qualified fiscal crimes all crimes specified under article 186 of the Federal Law of 14 December 1990 on Federal Direct Taxes (LFDT), and under article 59 par. 1, first comma of the Federal Law of 14 December 1990 on the harmonization of the Cantons and Councils direct taxes (LHDT), if the embezzled taxes are in excess of CHF 300'000 for the fiscal period.***
>
> *2. In serious cases, the penalty is a prison sentence not exceeding five years or a monetary penalty. A prison sentence is combined with a monetary penalty not exceeding 500 daily penalty units.*
>
> *A serious case is constituted, in particular, where the offender:*
> *a. acts as a member of a criminal organisation;*
> *b. acts as a member of a group that has been formed for the purpose of the continued conduct of money laundering activities; or*
> *c. achieves a large turnover or substantial profit through commercial money laundering.*
>
> *3. The offender is also liable to the foregoing penalties where the main offence was committed abroad, provided such an offence is also liable to prosecution at the place where it was committed."*

The combination of the tax fraud qualifying elements of the behavioural offence according to art. 186 FDTA and art. 59 para. 1 HDTA ("any person who uses falsified or altered documents for the purpose of misleading the tax authorities and committing tax evasion") and the realisation of the new elements which have been introduced in art. 305bis para. 1 and para. 1bis SCC ("tax embezzlement for an amount of over CHF 300'000 per fiscal period") will constitute the new qualified tax crime under Swiss law.

AMLA amendments and automatic exchange of information: consequences of the new law

The introduction of qualified tax crimes as predicate offence to money laundering has triggered amendments in several Swiss laws which, consequently, will also bring changes to the financial market place, in particular with respect to financial intermediaries through the modifications of the Swiss Anti-Money Laundering Act **(AMLA)**. From an even broader perspective, the impact will also be felt by other players in the financial sector with the continuous implementation of the Swiss Federal Council's decision to achieve extensive automatic exchange of information (AEI) and administrative assistance internationally.

1. Financial intermediaries

The Federal Council's decision to amend the AMLA in the wake of the adoption of the FATF Recommendations will prove onerous for financial intermediaries. This initiative is another example of what is generally known as "Swiss finish", meaning that the federal authorities went slightly beyond the actual expectations. This will result in a greater involvement of the financial intermediary in the verification of the client's tax situation. In addition to the full KYC (Know Your Client) analysis and identification of the ultimate beneficial owner, as in the past, the financial intermediary will now also have to understand the rationale for (i) the monetary transactions, (ii) the opening or operating of bank accounts in Switzerland and (iii) the setting up of a structure of companies and their genuineness, in order to ensure that the origin of funds is not the result of a predicate crime.

With the introduction of the new provisions in the AMLA and the SCC, the financial intermediary will also have to consider the funds under custody or management from a tax perspective and determine whether the CHF 300'000 tax avoidance threshold in one fiscal year has been reached. Reliance on the client's declaration will not suffice. Compliance with this requirement will entail an extensive knowledge of the tax situation of each client as well as of the applicable tax law in his/her home country. The financial intermediary's approach will be risk-based and require a large array of clues or "red flags" to be taken into account, like the use of offshore companies in the client's structure, transfers in cash, investments in exempted products, refusal to be sent any correspondence or tax extracts from the financial intermediary, the client being a PEP and so forth. In case of any doubts, in-depth information will have to be requested from the client and the explanations received will need to prove totally convincing. If this is not the case, the financial intermediary may (art. 305ter para. 2 SCC) or must (art. 9 AMLA) file a report with the MROS and will then be released from any civil or criminal responsibility.

These obligations will be applicable to all financial intermediaries, whether banks, independent asset managers, fund managers or lawyers acting as financial intermediaries and will go far beyond what is required from them in most European countries. The financial intermediaries will therefore become an extension of the federal and cantonal anti-money laundering authorities, which in turn may require the setting up of costly compliance departments, even for smaller structures. Clients will also be affected by these changes as a result of the increased internal costs assumed by financial intermediaries and the practical disappearance of banking secrecy. A substantial increase in reporting to MROS is definitely to be expected.

2. Automatic exchange of information (AEI)

The aforementioned legislative changes are the result of an ongoing effort undertaken since 2008 by the Swiss authorities to dispel the label of “tax haven” associated with Switzerland internationally. The first major changes were introduced as a consequence of the intense legal battle between the US and Switzerland over the famous UBS case. The term “tax fraud and the like”, which appeared in the first UBS court decisions, was the initial step that brought the Swiss authorities to review their opinion on banking secrecy and the prosecution of tax evasion and crimes. They then proceeded to amend the Federal Law on Tax Administrative Assistance permitting “group requests” according to international standards. The ensuing implementation of the FATCA requirements and the recent initialing of an agreement with the EU regarding the introduction of the global AEI standard demonstrate Switzerland’s intention to actively contribute to the prevention of tax evasion worldwide.

The amendments brought to art. 305^{bis} and art. 305^{ter} of the SCC are in line with the Federal Council’s policy to ensure an open flow of information between various authorities, and, even though tax evasion is still not a criminal offence in Switzerland, it is now clear that maintaining undeclared assets in Swiss banks will no longer be possible. The banks themselves will ensure that they do not keep undeclared assets as they have done in the past, for example for US and French citizens.

Transition period

As to the timeline of these various amendments, the Federal Council has decided to enact the new law, the Implementation of the 2012 Revised FATF Recommendations Act, in two stages:

- On **1 July 2015**, the amendments to the Swiss Code of Obligations, the Collective Investment Scheme Act and the Federal Intermediated Securities Act will enter into force.
- As of **1 January 2016**, the amendments to the Swiss Civil Code, the provisions on tax predicate offences (amendment to the SCC), the amendments to the Debt Collection and Bankruptcy Act as well as to the AMLA will become effective.

Hence, the aforementioned changes to the SCC and to the AMLA regulations will enter into force on 1 January 2016 and the necessary preparatory work for its implementation should be completed as of the beginning of next year. With respect to the amended provisions of the SCC, special transitional provisions apply: art. 305^{bis} SCC will not apply to qualified tax crimes in the sense of art. 305^{bis} para. 1^{bis} SCC that have been committed before the entering into force of the amendments on 1 January 2016. Consequently, only qualified tax crimes committed after that date shall be considered as a predicate offence to money laundering.

Summary

The new act requires a broad range of persons and institutions to adapt their structures and processes in order to comply with the latest applicable provisions. For example, bearer share registers must be set up by Swiss companies and enhanced money laundering documentation must be drawn up and implemented. Financial intermediaries in particular will have to thoroughly verify their clients’ tax situation. Moreover, qualified tax crimes now being a predicate offence to anti-money laundering, this is likely to increase the reporting to MROS and the number of investigations into suspicious cases. Individuals as well as legal entities subject to the new law should start taking the necessary measures to ensure compliance in due time.

Contact

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Geneva office

Cyril Troyanov
Partner, Geneva
troyanov@altenburger.ch
Rue Toepffer 11bis
1206 Geneva

Lillian Chavan-van Campen
Corporate Lawyer, Geneva
chavan@altenburger.ch
Rue Toepffer 11bis
1206 Geneva

Lugano office

Denise Pagani Zambelli
Associate, Lugano
pagani@altenburger.ch
Piazza Rezzonico 6
6900 Lugano

Zurich office

Melissa Gautschi
Partner, Zurich
gautschi@altenburger.ch
Seestrasse 39
8700 Küsnacht-Zurich

Sophie Winkler
Associate, Zurich
winkler@altenburger.ch
Seestrasse 39
8700 Küsnacht-Zurich