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VIEWPOINTS

The Swiss Perspective on Information Exchange

by Marcus Desax

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It was just 33 years ago, in 1977, when I started my first job as an attorney at the Geneva European headquarters of DuPont Co. My assignments were widespread:

- I negotiated general conditions of sale with a state-owned foreign trade organization of the Union of Soviet Socialist Republics.
- I reviewed joint venture agreements in Yugoslavia.
- I struggled with the distinction between *pesetas interiores* and *pesetas exteriores* for Spanish exchange control purposes.

These interesting topics are all gone: In Russia, there was glasnost and perestroika; Tito and the Yugoslav system of public-private partnership have disappeared; and the Spaniards now pay for their glass of Rioja wine or Carlos I brandy with euros and, fortunately, have forgotten all about exchange control.

It will not come as a surprise to you that after some years of practice in these highly volatile political domains, I felt the need to operate in a more stable area of the law. That's why I became a tax lawyer!

1977 was also an important year in international tax law. The OECD replaced the old 1963 model convention with a new one. Particularly, it widened the scope of the provision dealing with exchange of information.

Switzerland was not happy about this state of affairs. It made the following reservation to article 26 of the 1977 OECD model:

> Under the Swiss concept a double taxation convention aims at avoiding international double taxation; the information necessary for the correct application and for the prevention of an abuse of such a convention can be exchanged already within the existing framework of its provisions on the mutual agreement procedure, the reduction of taxes withheld at source, etc. Switzerland considers a particular provision on the exchange of information as unnecessary.

That position would be upheld for 20 years. However, in the treaties entered into with the United States in 1996 and with Germany in 2002, Switzerland had to modify its position and grant information in the event of tax fraud and the like. In 2005 Switzerland amended its reservation to article 26 of the OECD model to read as follows:

> Switzerland reserves its position on this Article. It will propose to limit the scope of this Article to information necessary for carrying out the provisions of the Convention. This reservation shall not apply to cases involving acts of fraud subject to imprisonment according to the laws of both States.

Why was this so? It is important to point to a major difference between the tax-assessment procedures in Switzerland and in many other countries.

As I understand it, in the United States, a U.S. person completes his tax return, calculates the tax due directly on the return, and sends the return and a check for the tax due directly to the IRS. Unless he is one of the unfortunate 5 percent of taxpayers selected at random, he never hears from the IRS. This system of self-assessment is practiced in many countries.

Switzerland also has the system of self-assessment for indirect taxes: A Swiss company distributing a dividend reports it to the Swiss Federal Tax Administration on his own initiative and pays the tax. The same applies for a merchant: On a quarterly basis, he reports his turnover to the VAT administration, calculates the VAT due, deducts the amount of input VAT, and pays

the balance to the government. That is, the taxpayer exercises an official function in the levy of an indirect tax — he determines the amount of tax due and pays it on his own initiative.

For income taxes, however, the procedure is different. The Swiss taxpayer, be it an individual or a corporation, fills in the tax return and sends it to the tax administration. The tax official in charge, within a year or two, examines the tax return, may ask additional questions and demand evidence for deductions claimed, and finally issues the tax assessment. If the taxpayer disagrees with the tax assessment, he may file an opposition against it, and eventually the courts will decide. For income taxes, it is the tax official, not the taxpayer, who determines the amount of the tax.

The relationship of the Swiss taxpayer to the government, therefore, is essentially different depending on whether indirect or income taxes are at issue. The sanctions are also different for providing false information.

For indirect taxes, the Swiss taxpayer is subject to imprisonment if he is found guilty of having established a ''scheme of lies.'' For example, a VAT carousel — widespread in the European Union where input VAT is claimed but no VAT is actually paid — would be considered a scheme of lies.

Regarding income taxes, however, a taxpayer is imprisoned only if he falsifies documents, such as books of account, salary statements, or bank documentation. Merely supplying false information on a tax return, such as hiding items of assets or income, is subject to a civil penalty of up to three times the amount of taxes evaded. No criminal sanctions are imposed.

Under the 1977 Swiss reservation to article 26 of the OECD model, and under the tax treaties entered into thereunder, in handling a request for exchange of information, the requested Swiss authority examines whether the person under investigation supplied inaccurate information or falsified documents. If there is mere nondisclosure of otherwise taxable income, no criminal sanction would be imposed in Switzerland; consequently, Switzerland does not grant administrative assistance for such cases of tax evasion.

You may wonder why Switzerland does not criminally prosecute evasion of income tax not involving falsification of documents and only issues something like a hefty traffic ticket. There are several reasons:

- The Swiss tax authorities have sufficient means to efficiently combat tax evasion: If a taxpayer does not respond to a request of the tax authorities to supply evidence or to explain facts — such as an increase of assets from one year to the other — the tax administration can tax the taxpayer upon its best estimate. Remedies against such assessment are limited and will be heard only if there is full disclosure. The threat of assessment upon best estimate is often sufficient to encourage taxpayers to fully comply.
- Dividends and interest are subject to a 35 percent withholding tax, which is recoverable only if such items of income are declared in the tax return. This unrecoverable withholding tax, together with the civil fine of up to three times the amount of the tax evaded, is considered a sufficient financial penalty for tax evasion.
- The right of Swiss citizens to vote on major expenditures at the municipal and cantonal levels, and on the rates of municipal, cantonal, and federal taxes, all embedded in the federalist system of government, entails a high level of acceptance of the still moderate (compared with other countries) tax burden. International studies have shown that the tax gap is substantially lower in Switzerland than in many other countries.
- Generally, there is a consensus in Switzerland that the government is to serve the people, not the other way around. This guarantees that the relationship between taxpayers and tax authorities is cooperative, not confrontational. Consequently, a tax administration, the same as any other governmental body, needs good (that is, specific) reasons to access private data.

So far from the good old days!

As you all know, things have changed dramatically in the last few months.

On February 18, 2009, the United States and Swiss bank UBS entered into a deferred prosecution agreement. In this agreement, UBS acknowledged that beginning in 2000 and continuing until 2007, it participated in a scheme to defraud the United States by actively assisting U.S. individual taxpayers in establishing accounts at UBS in a manner to conceal the taxpayers' ownership or beneficial interest. The agreement was conditioned on a limited number of UBS customer files to be remitted to the U.S. Department of Justice. The same day, the Swiss Financial Market Supervisory Authority (FINMA) remitted 255 account files to the U.S. embassy.

At about the same time, the international press announced that the G-20, at its forthcoming meeting on April 3, 2009, would blacklist all states that do not cooperate in the international exchange of information for tax purposes.

To avoid being blacklisted, the Swiss federal government decided to withdraw the reservation to article 26 of the OECD model and to renegotiate existing tax treaties in order to grant administrative assistance according to OECD standards. Since then, some 25 treaties have been initialed or signed. In June the Swiss parliament will decide on the ratification of the first ones, including the treaty with the United States.

Is the floodgate now open for all-encompassing requests for production of banking documentation? Is Swiss banking secrecy a thing of the past?

I don't think so for the following reasons:

- The Swiss federal government has emphasized that administrative assistance will be granted only prospectively, not retroactively. Hence, most newly negotiated treaties provide that exchange of information is granted only for tax periods starting on or after January 1 following the entry into force. The treaty with the United States has a different rule: Banking information may be demanded for periods starting on or after September 23, 2009 (that is the date of initialing of the tax treaty); nonbanking information can be obtained for tax periods starting on or after January 1, 2010. ''Fishing expeditions'' are excluded. Only information ''foreseeably relevant'' (in most treaties) or information ''as may be relevant'' (in the treaty with the U.S.) will be provided. The person under investigation must be clearly identified, and the name and address of the bank must be stated. Indications must be provided that the person under investigation owns an account at a given Swiss bank.
- Information is exchanged only upon request; Switzerland continues to oppose an automatic exchange.
- Swiss bank secrecy can no longer be opposed to a properly motivated demand of administrative assistance under an existing tax treaty. In all other areas, however, it continues to exist and the Swiss government is determined to vigorously enforce it. If Swiss bank data are stolen and bank documentation is demanded based on information that the foreign government has purchased from the thief, the assistance will be refused.

Before closing, allow me to make a few personal remarks:

- First a cynical one: Thanks to the financial crisis of 2008 and the ensuing G-20 action against perceived tax havens, Switzerland had to give up its restrictive practice regarding information exchange, as did all other countries that offered similar protection. Had there not been the global crisis and had Lehman Brothers not gone under a few months earlier, the United States might have pursued the criminal case against UBS. The consequence might have been not only that Switzerland may have lost its largest bank with all systemic consequences, but also that all undisclosed assets in Swiss banks might have been remitted to ''more attractive'' jurisdictions. Now, there is a level playing field. Some 20 years ago, a leading Swiss private banker wrote that bank secrecy renders Swiss bankers fat and impotent. Now, if Swiss banks want to keep their international customers, they must provide better service, offer higher performance, and, above all, be more reliable than their worldwide competitors. This is certainly a challenge, but also an opportunity.
- The change of Swiss treaty policy would be considered timely even without the UBS catalyst: The international consensus regarding cross-border enforcement of tax law has evolved since the OECD issued its first model treaty in 1963. The position can no longer be taken that the exclusive aim of tax treaties is to avoid double taxation.
- Switzerland's distinction between noncriminal tax evasion and criminal tax fraud is difficult to explain not only to ordinary Swiss people but even to lawyers and politicians in countries that do not make such a distinction. To make exchange of information dependent on such legal quibble is bound to fail in the long term.
- If Switzerland wants to further defend privacy and protect its banks against criminal activities, it will be in a better position if it provides information upon request.
- The procedural safeguards permit distinguishing proper requests from spurious ones. To the extent possible, they protect the justified interests of the banks and their customers.

I mentioned at the beginning that during my early days as a lawyer, I wanted to get out of volatile political matters and into a more stable area of the law. Well, tax law has proven to be one of the most politicized areas of law, nationally and internationally. This may be unfortunate, but is hardly avoidable. Because it is not possible to remove politics from the field of law, we as tax practitioners must see to it that the rule of law is never removed from the field of politics. ◆