

Exchange of information – Switzerland can no longer bank on secrecy

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2009 WAS MARKED BY THE HISTORIC AND DRAMATIC DECISION OF THE SWISS GOVERNMENT ON MARCH 13, 2009 TO ADOPT THE OECD STANDARDS REGARDING EXCHANGE OF INFORMATION, AS LAID DOWN IN ARTICLE 26 OF THE OECD MODEL TAX CONVENTION. THIS DECISION IMPLIES AN IMPORTANT BREACH OF THE COUNTRY'S CENTURY-OLD STRICT BANK SECRECY RULES. THE DECISION ALSO MEANS THAT SWITZERLAND CAN NO LONGER BANK ON SECRECY AND SERIOUSLY NEEDS TO CONSIDER TAX REFORM IN ORDER TO GENERATE ALTERNATIVE REVENUE.

1. Switzerland's historic move towards extended exchange of information

On March 13, 2009, the Swiss government announced the extension of its exchange of information policy to meet the standards of the OECD. On May 26, 2009, the government further announced that the negotiators in charge of implementing provisions fully complying with article 26 (administrative assistance in tax matters) of the OECD Model Tax Convention had already initialled the first three treaties with such relevant clauses.

Following the announcement of a change in policy, 23 OECD Member States announced interest in revising their double tax treaties with Switzerland to include the new information exchange provisions. In turn, Switzerland wanted to demonstrate that it is quick to meet its commitments and that it did not intend to drag out discussions. Switzerland has also occasionally used the negotiations to obtain advantages for its economy by obtaining certain exemptions, arbitration clauses and removing discriminatory provisions in existing treaties that were applied because Switzerland did previously not accept a full information exchange clause.

Right from the beginning, Switzerland gave priority to negotiations with Norway, Denmark, Luxembourg, Poland, Japan, the Netherlands and the US. Switzerland was



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particularly keen to initial an information exchange agreement with the US in order to alleviate some of the tensions that had developed as a result of the UBS scandal as well as the Stop Tax Haven Abuse Act and other US tax proposals.

In order to upgrade Switzerland from the OECD's G-20 grey list to the white list, a minimum of 12 fully compliant exchange of information agreements needed to be signed with OECD Member States before year-end 2009 under G-20 requirements.

On September 25, 2009, Switzerland announced the signing of the 12th renegotiated tax treaty with Qatar and therefore it met the deadline in order to be removed from the grey list and to be promoted to the OECD's G-20 white list. As per that date, Switzerland has signed extended exchange of information agreements with Austria, Denmark, the US, Finland, France, the UK, the Faroe Islands, Luxembourg, Mexico, Norway and Qatar. The tax treaty with Spain contains a special 'most favoured nation' clause regarding exchange of information provisions agreed upon with other EU Member States and the newest policy is thus automatically applicable under the treaty with Spain, which makes a total of 12. Moreover, Switzerland has already initialled exchange of information agreements with Japan, the Netherlands, Poland and Singapore and these agreements should be signed soon as well.

The texts of the new agreements have been submitted to and approved by the Swiss government and to the cantonal authorities, as well as to the Swiss business community. Subsequently, the Swiss government will approve the texts and submit them to parliament for ratification. The first renegotiated treaty which will be submitted to the Swiss parliament will also be subject to an optional referendum by the Swiss voters should the Swiss parliament require it, as is likely, or if at least 50,000 people request a public vote by referendum. In practice, the Swiss government requires only the first treaty introducing a major change in policy to be subject to the optional referendum. However, the Swiss parliament has the final power to make that decision, and

some members of parliament are requesting that each renegotiated tax treaty be subject to an optional referendum.

Because of the national ratification procedures in Switzerland, possibly involving a referendum, it is unlikely that the new information exchange agreements will enter into force by 2010, but as Switzerland negotiated, initialled and subsequently signed at least 12 agreements before year-end, it showed sufficient good faith and was removed from the OECD G-20 grey list on September 24, 2009.

2. The new Swiss policy regarding exchange of information

As per the Federal Council's decision of March 13, 2009, Switzerland has lifted its reservation on paragraphs 1 and 5 of article 26 of the OECD Model Tax Convention, which means that Switzerland will in the future also exchange information necessary for the enforcement of domestic laws of the other contracting state (not limited to the application of the treaty as such) and will no longer decline to exchange that information based on Swiss bank secrecy rules.

In a statement released on March 13, 2009, the Swiss Federal Council emphasised that the new Swiss policy in the field of exchange of information will be subject to the following conditions and restrictions:

- there will be no automatic exchange of information;
- the established administrative assistance procedures must be respected, and international cooperation in tax matters must exclusively take place with the framework of treaty- or agreement-based provisions and institutions;
- administrative assistance will be limited to individual cases when a specific and justified request has been made, that is, no information will be exchanged in case of fishing expeditions;
- fair transitory solutions must be found;
- the information to be exchanged must be restricted to taxes that fall within the framework of the respective double tax treaty;

- the principle of subsidiarity as laid down in article 26 of the OECD model tax convention must be respected; and
- the other contracting state must be willing to eliminate discrimination.

The latter condition specifically refers to treaty partners that have in the past included, introduced or applied discriminatory provisions because Switzerland applied a rather restrictive policy in the field of information exchange.

Also, Swiss domestic law provides for procedural rights protecting the interest of taxpayers, Swiss and foreign residents alike. Based on these rules, before any information can be exchanged, the taxpayer concerned will first be informed of, then has the right to be heard on, and finally has the right to object to (and eventually appeal before the Swiss Federal Administrative Court) a decision made by the Swiss Federal Tax Administration to exchange information. The objection or appeal notably suspends any exchange of information.

Switzerland will of course continue to negotiate extended information agreements with other countries and with the EU within the framework of the EU-Swiss Savings Agreement and it intends to participate actively in the organisation of an efficient international supervision in order to achieve a worldwide unified application of the standards regarding exchange of information.

Finally, in an effort to create consistent policy based on the concessions made, the Swiss government announced on May 29, 2009 that international judiciary assistance will now be extended to cases of tax evasion. The current legal provisions limit judiciary assistance to cases of tax fraud. Now that the first round of bilateral double tax treaties has been renegotiated, the Swiss government will start negotiating international judiciary assistance treaties and later will adapt relevant Swiss federal law accordingly.

3. Other Swiss tax treaty news

United Kingdom

The principal amendment to the 1977 Swiss-UK treaty concerns the full exemption of withholding tax of dividends paid to a parent legal entity owning at least 10% of the

paying entity. Dividends distributed to pension funds are also fully exempted. If these conditions are not met, the higher withholding tax rate remains at 15%. The protocol of amendments entered into force on December 22, 2008. Moreover, an arbitration clause in conformity with the OECD Model Arbitration Clause was included in the treaty.

Germany

The negotiating parties have agreed that, as of January 1, 2009, as per a new article 15 §4 in the 1971 German-Swiss treaty, income derived by an executive is only taxable in state of residence of the executive, provided the latter is registered with the trade registry in that state.

Pakistan

A new income tax treaty between Pakistan and Switzerland was signed on July 19, 2005 and entered into force the same day. The new treaty replaces the 1959 treaty, which was the first treaty concluded by Switzerland with a developing country. The new treaty provisions are applicable in Switzerland as of January 1, 2009, and in Pakistan as of July 1, 2009. The new treaty is generally based on the OECD Model Tax Convention and conforms to current Swiss tax treaty policy, except for some minor changes based on the UN Model Tax Treaty. Finally, the treaty contains a tax sparing credit which applies, under conditions, to Pakistan-source interest income in the hands of a Swiss recipient.

Qatar

On November 30, 2008, Switzerland and Qatar signed a treaty avoiding double taxation of income derived by air transportation. Once the two states will have finalised their respective ratification procedures, the treaty will enter into force with retroactive effect as of 2004. Moreover, a first-time double tax treaty was signed on September 25, 2009. Besides introducing the extended information exchange clause, the treaty provides that withholding tax on dividends will be reduced to 5% if the beneficiary is a legal entity, respectively 10% if the beneficiary is an individual, owning at least 10% of the company paying the dividend. In other cases, the withholding tax rate will amount to 15%. Moreover, interests and royalties are fully exempted.

Malta

A first-time double tax treaty was signed on December 18, 2008. The signed treaty still has to be ratified by the Swiss parliament and will possibly be applicable as per January 1, 2010. The treaty notably provides for a full exemption from withholding tax on dividends and royalties. Interest will be taxed at source at a rate of 10%, except for bank interest and interest paid for goods purchased against credit.

Algeria

A new treaty entered into force on February 9, 2009 and will be applicable from January 1, 2010. It is generally based on the OECD Model Tax Convention and conforms to current Swiss tax treaty policy. Besides eliminating double taxation, the new treaty provides for an institutional protection, particularly to businesses investing in both contracting states. This first-time treaty should contribute to the bilateral economic developments between the contracting states and will eliminate a gap in the Swiss treaty network with North Africa.

South Africa

A new treaty entered into force on January 27, 2009 and is applicable with regard to withholding tax from January 1, 2010 and from the next fiscal year starting on or after this date for the other taxes. The new treaty provides for a 5% withholding tax rate on parent/subsidiary dividends and a 5% maximum rate on interest payments.

Indonesia

A modified treaty entered into force on March 20, 2009. The principal modification consists of reducing the maximum withholding tax rate on royalties from 12.5% to 10%. The protocol also improves the tax conditions of Swiss enterprises active in Indonesia.

Denmark

On August 21, 2009, Switzerland signed the protocol negotiated with Denmark and this was the first signed agreement containing an extended exchange of information clause. Besides the latter clause, the contracting states also decided to limit the application of the 'zero rate' to dividends paid by an entity in which the beneficiary of the dividend owns at least 10% of the share capital and to qualifying pension schemes. In all other cases, the

withholding tax rate is limited to a maximum of 15%.

Furthermore, pensions paid by private pension funds will be taxable as a priority in the source state. Finally, the contracting states introduced an arbitration clause in conformity with the OECD Model Arbitration Clause.

Luxembourg

On August 25, 2009, Luxembourg and Switzerland signed the protocol modifying the double tax treaty. Besides introducing an extended exchange of information clause, the contracting states decided to reduce the shareholding threshold of 25% to 10% in order to benefit from the withholding tax exemption. The latter exemption is also applicable to dividends paid to pension funds. The revised treaty contains an arbitration clause which corresponds to the OECD Model Clause.

Mexico

On September 18, 2009, Switzerland and Mexico signed a new treaty providing, besides the extended information exchange article, for a withholding tax exemption on dividend if the beneficiary is a legal entity owning at least 10% of the paying entity, as well as a reduced withholding tax rate of 5% or 10% on interest. Finally, a most favoured nation clause was agreed for interest and royalty payments, which guarantees that Switzerland will receive the most favourable treatment granted by Mexico to OECD Member States under its bilateral double tax treaties.

France

Switzerland and France signed a new treaty on August 27, 2009 which has yet to be adopted by the Swiss Parliament. The treaty contains a new exchange of information clause that should not have any retroactive effect as this was particularly required by the Swiss Bankers Association in their letter of August 3, 2009 to the Swiss Federal Tax Administration. Although fishing expeditions are excluded, experts remain divided based on the text of the treaty, in particular concerning the obligation to provide (or not) the name of the bank. In the Swiss view, the new provision must be interpreted in accordance with what was announced by the Swiss government on March 13, 2009, i.e., the normal rules of article 26 of the OECD Model Tax Convention will apply. In this respect, the Swiss

	Withholding tax rates				Withholding tax rates		
	Dividend	Interest	Royalty		Dividend	Interest	Royalty
Albania	15/5%	5%	5%	Latvia	15/5%	10/0%	10/5%
Algeria	1) 15/5%	10/0%	10%	Lithuania	15/5%	10/0%	10/5%
Argentina	2) 15/10%	12/0%	15/10/5/3%	Luxembourg	15/5/0%	10/0%	0%
Armenia	15/5%	10/0%	5%	Macedonia	15/5%	10/0%	0%
Australia	15%	10%	10%	Malaysia	15/5%	10/0%	10/0%
Austria	15/0%	0%	0%	Malta	8) 0%	10/0%	0%
Azerbaijan	15/5%	10/5/0%	10/5%	Mexico	15/5%	15/10%	10%
Bangladesh	8) 15/10%	10/0%	10%	Moldova	15/5%	10/0%	0%
Belarus	15/5%	8/5/0%	10/5/3%	Mongolia	15/5%	10/0%	0%
Belgium	15/10%	10/0%	0%	Montenegro	5) 15/5%	10%	10%
Bulgaria	15/5%	10/0%	0%	Morocco	15/7%	10%	10%
Canada	15/5%	10/0%	10/0%	Netherlands	15/0%	5%	0%
Chile	8) 15%	15/5%	10/5%	New Zealand	15%	10%	10%
China	10%	10/0%	10%	Norway	15/0%	0%	0%
Columbia	8) 15/0%	10/0%	10%	Pakistan	4) 20/10%	10/0%	10%
Croatia	15/5%	5%	0%	Philippines	15/10%	10%	15%
Czech Republic	15/5%	0%	5%	Poland	15/5%	10%	0%
Denmark	9) 0%	0%	0%	Portugal	15/10%	10%	5%
Ecuador	15%	10/0%	10%	Qatar	8) 15/10/5%	0%	0%
Egypt	15/5%	15/0%	12.5%	Romania	10%	10/0%	0%
Estonia	15/5%	10/0%	10/5%	Russia	15/5%	10/5/0%	0%
Finland	10/0%	0%	0%	Serbia	5) 15/5%	10%	10%
France	15/0%	0%	5%	Singapore	15/10%	10/0%	5/0%
Germany	15/0%	30/0%	0%	Slovak Republic	15/5%	10/0%	5/0%
Ghana	8) 15/5%	10%	8%	Slovenia	15/5%	5%	5%
Greece	35/15/5%	10%	5%	South Africa	6) 7.5%	10/0%	0%
Hungary	10%	10%	0%	South Korea	15/10%	10/0%	10%
Iceland	15/10/5%	0%	0%	Spain	7) 15/0%	0%	5%
India	10%	10/0%	10%	Sri Lanka	15/10%	10/5%	10/5%
Indonesia	3) 15/10%	10%	10/5/0%	Sweden	15/0%	5%	0%
Iran	15/5%	10/0%	5%	Thailand	15/10%	15/10/0%	10/5%
Ireland	15/10/5/0%	0%	0%	Trinidad and Tobago	20/10%	10%	10/5%
Israel	15/10/5%	10/5/0%	5%	Tunisia	10%	10%	10%
Italy	15%	12.5%	5%	Turkey	8) 15/5%	15/10/5/0%	10%
Ivory Coast	15%	15/0%	10%	Ukraine	15/5%	10/0%	10/0%
Jamaica	15/10%	10/5%	10/6/5%	United Kingdom	15/0%	0%	0%
Japan	15/10%	10/0%	10%	United States	15/0%	0%	0%
Kazakhstan	15/5%	10/0%	10%	Uzbekistan	15/5%	5/0%	5%
Kuwait	15%	10%	0%	Venezuela	10/0%	5%	5%
Kyrgyzstan	15/5%	5%	5%	Vietnam	15/10/7%	10/0%	10%

- 1) The treaty with Algeria was signed on June 3, 2006 and entered into force on January 9, 2009 and is applicable from January 1, 2010.
- 2) The treaty is expected to be applicable as per January 1, 2010 and is applied on a provisional basis since January 1, 2001.
- 3) A protocol entered into force on March 2009, applicable from January 1, 2010, which reduced the high withholding tax rate on royalties from 12.5% to 10%.
- 4) A new treaty entered into force on November 24, 2008, and is applicable in Switzerland from January 1, 2009, and in Pakistan from July 1, 2009.
- 5) After the independence of Montenegro on June 3, 2006, the 2005 Swiss treaty with Serbia-Montenegro will be applied to both Serbia and Montenegro separately, and both as of January 1, 2007, based on an exchange of notes between the countries respective foreign affairs departments.
- 6) A completely new treaty signed in Pretoria on May 8, 2007, provides for a 5% withholding tax rate on parent/subsidiary dividends and a 5% maximum rate on interest. The new treaty entered into force on January 27, 2009, and is applicable from January 1, 2010.
- 7) The withholding tax on royalties will be lowered to 0% as of July 1, 2011.
- 8) New, first-time treaty signed and submitted to the Swiss parliament for ratification. Possibly applied as per January 2010.
- 9) A revised treaty has been signed which provides for a 15/0% withholding tax rate on dividends. Possibly applied as per January 1, 2010.

Source: Information published by the Swiss Federal Tax Administration as per October 1, 2009

government may confirm in its message to the parliament and possibly in a special ordinance (as proposed by the Swiss Bankers Association) its interpretation of the clause.

The new treaty with France further includes a special Limitation on Benefits (LOB) provision. This special provision extends the application of the LOB provision already existing in article 11 of the existing treaty to French dividends paid as of July, 1, 2005, by French subsidiaries to Swiss parent companies under article 15, paragraph 1 of the EU-Swiss Savings Agreement. In case the Swiss parent company is controlled by persons that are third country residents, the exemption is not given. This new provision is 'special' as it is the first time a reference is made to a multinational agreement such as the EU-Swiss Savings Agreement in a bilateral tax treaty concluded by Switzerland.

The new treaty also introduces a new paragraph in article 20 stating that if the residence state partially or wholly exempts pensions from tax according to its domestic law, the source state is authorised to levy a tax on the pension paid on the part not imposed in the residence state. Before this new paragraph, a lump-sum (capital) payment of a pension made by a Swiss pension fund to a French resident escaped French taxation as there is no French domestic provision to assess such a payment whereas Switzerland had no right to levy a tax at source. With the new provision, Switzerland may retain a final withholding tax on such payments as long as France does not impose such lump-sum payments under its domestic tax rules. The revised treaty also contains an arbitration clause in conformity with the OECD Model Arbitration Clause.

Norway

On September, 2, 2009, Switzerland and Norway signed a protocol revising their double tax treaty in order to include an extended exchange of information clause. Moreover, the new treaty provides that no withholding tax on dividends will be applied if the parent company holds at least 10% of the share capital of the dividend paying entity 10%. Furthermore, a right to levy pensions at source at a maximum rate of 15% was introduced. Finally, the protocol also provides for a 'most favoured nation' clause in case Norway would introduce an arbitration clause in a bilateral tax treaty with another state.

Austria

On September 4, 2009, Switzerland and Austria signed the modified double tax treaty introducing not only an extended exchange of information clause, but also an arbitration clause in conformity with the OECD Model Arbitration Clause.

The Faroe Islands

On September 24, 2009, Denmark and Switzerland decided to extend the scope of their bilateral tax treaty, which also contains an extended information exchange clause, to the Faroe Islands.

Finland

On September 24, 2009, Switzerland and Finland signed a new tax treaty. Besides the extended information exchange clause, the parties reduced the threshold for substantial participations to benefit from the withholding tax exemption on dividends from 20% to 10%.

United States

A new amending protocol was signed on September 24, 2009 between Switzerland and the US. Besides the extended information exchange clause, a new arbitration clause was introduced which corresponds to the relevant OECD model clause. According to the new clause, if after two years the contracting states have not reached an agreement as per the mutual agreement procedure, the unresolved case will, upon request of the taxpayer concerned, be dealt with by an arbitration procedure. Moreover, the new treaty provides that dividends paid to individual pension funds (in Switzerland: Pillar 3a) are not subject to taxation in the source state. Currently, only employer-linked pension funds benefit from a withholding tax exemption.

Switzerland and the US further decided to continue the negotiations over the next two coming years in order to for example, agree on an exemption from withholding tax on dividends. Based on the new extended exchange of information provisions, an administrative assistance request has to be filed by the competent authority and needs to allow for a clear identification of the taxpayer concerned and, in case of bank information, needs to contain the name of the bank concerned. The new clauses

have no retroactive effect. However, the date of signature of the revised treaty is decisive for exchange of bank information. Finally, fishing expeditions are excluded as in other new exchange of information agreements.

4. The need to generate new revenue

The major concessions made by the Swiss government in the field of bank secrecy and information exchange have avoided Switzerland being blacklisted by the G-20 members. It is hoped that these concessions avoid the blacklisting in the US Stop Tax Haven Abuse Act. Furthermore, the general discussion climate around Switzerland should become friendlier, be it with the US, the OECD, or the EU. Clearly, with these concessions Switzerland can no longer bank on secrecy and this will have negative consequences for the country's important

offshore banking industry. However, being blacklisted could have had much worse consequences for the Swiss economy as whole.

What still remains to be seen is whether and to what extent Switzerland will effectively be able to negotiate and implement its policy with the announced restrictions on information exchange and whether it will be able to get some concessions in return, for example, the removal of discriminatory provisions in place because of the lack of Swiss administrative assistance.

Once the dust has settled, Switzerland is in dire need of self-reflection about its role as an important financial and business centre in a rapidly changing world. The country must seriously consider tax reform to remain an attractive location for the financial services industry but also for multinational companies to compensate for revenue that will be lost by its offshore banking industry.