Current News

Swiss Bank Secrecy: Protect your assets!

Now that Switzerland has decided to grant administrative assistance to foreign tax authorities in cases of tax fraud according to the criteria of the requesting state[1], the question arises as to a) when this larger exchange of information will start, and b) what information will be sent from Switzerland to the requesting states. This information is important to determine what can and what should be done **(hide, disclose, or dispose of such assets)** to limit the risks for clients of Swiss Banks resulting from the new Swiss policy with respect to the exchange of information in tax matters. The special situation of US Tax payers is the subject of a separate memorandum[2].

a) The Swiss government has indicated that the new rules should apply in a fair way, meaning that the foreign states should not be allowed to take advantage of the Swiss change of practice. Clients of Swiss banks should be protected in their good faith reliance on the Swiss practice of not giving any information in case of tax avoidance but only in cases of tax fraud.

   In practice this means that, despite what some foreign governments may suggest to scare their taxpayers, the revised exchange of information rules will apply without retroactive effect, i.e. the exchange of information will not cover information related to issues older than the date when the new rules were agreed and made public, in practice not before January 1, 2010 at the earliest[3]. Therefore nothing will change for the clients of Swiss banks as long as the tax treaties have not been renegotiated by Switzerland. Once the amended text of the revised tax treaties have been approved by the governments of the contracting states, they are made public and the treaties have then to be ratified by the parliaments of the contracting states. This will not happen overnight. But, contrary to what was initially understood, the exclusion of retroactive effect may not necessarily cover the period between the signature of the revised treaty and its ratification because during that period the new rule to come was known to the public. Therefore no time should be lost to adjust to the new rules now!

b) Switzerland will have to obtain and to provide information accessible to the Swiss authorities, even if the Swiss tax authorities do not need it for Swiss tax assessment purposes. If the information is available in Switzerland, then the Swiss authorities will have to get it and forward it to the foreign tax authorities upon specific request. This excludes any automatic exchange of information as practiced for instance within the EU.

   The information will have to be provided even if it is held by a bank, a nominee or a person acting in an agency or a fiduciary capacity, but Swiss lawyers' secrecy remains fully protected provided the lawyer has acted in Switzerland and only as an advisor, legal advice being considered to include advice on tax matters, but not additional activities such as financial intermediary activities, i.e. helping transferring assets, for instance by forwarding banking instructions or other banking documents[4].

   The due diligence rules applicable in Switzerland in the context of the anti-money laundering legislation represent the main threat to Swiss bank secrecy, and at the same time the main source of potentially interesting information for foreign tax authorities, because every bank and financial intermediary in Switzerland has staff whose primary function is to gather as much information on clients and beneficial owners of assets held in Swiss banks as possible to document the "know your customer rules" and in this way to meet the strict requirements set by the Swiss regulatory authorities.

[1] *Switzerland to adopt OECD standard on administrative assistance in fiscal matters*
http://www.efd.admin.ch/dokumentation/medieninformationen/00467/index.html?lang=en&msg-id=25863

[2] *Swiss Bank Secrecy Why US taxpayers are more in trouble than others.*
http://www.stswiss.com/shared/publications/Swiss%20Bank%20Secrecy%20Why%20US%20taxpayers%20are%20more%20in%20trouble%20%20than%20others.pdf

[3] *Procedure before new or amended treaties enter into force and timetable of what information becomes available*
http://www.efd.admin.ch/00468/index.html?lang=en&msg-id=28889

[4] *UK Swiss agreement to exchange information in tax matters signed on September 7, 2009. Professional secrecy is not a reason to refuse to communicate requested information:*
http://www.news-service.admin.ch/NSBSubscriber/message/attachments/16735.pdf
It remains to be tested to what extent Swiss lawyers' secrecy for legal advice is really protected as the Swiss government claimed in the past!

Compliance officers in the Swiss financial institutions are audited at regular intervals to make sure that they have information making it possible to link the funds held in Swiss banks to individuals and that such information is regularly updated, classified and stored so that it can be easily retrieved in case of enquiry by the Swiss authorities. The compliance activities are however never checked to ensure that only correct information is kept, nor are they audited to make sure that no more information is kept than what is necessary to meet the due diligence requirements. This is where action is needed on the part of the clients of Swiss banks[5]. The clients should check, with the help of their legal advisors, that the banks' files do not contain information that is false or not absolutely necessary.

The Swiss authorities and bankers need to be better educated about trusts in order not to disclose more information than their Anglo Saxon counterparts. The new Agreement between Germany and the Isle of Man signed on March 2, 2009 presented as leading agreement for information to be exchanged in tax matters by offshore jurisdictions does, for instance, not provide for information on protectors (art. 4b iii and iv), nor for information on the persons who have caused the settlor to settle the trust[6].

For "Due Diligence" purposes Swiss banks must gather information on the beneficial owners of companies and on beneficiaries of trusts and foundations and on the origin of the assets (inheritance, business income, etc.). If the trust or the foundation is an irrevocable discretionary trust or foundation, the bank must have information on the "actual" founders or settlors and not only on those acting in a fiduciary capacity or as nominees (CDB08 art. 4. 43). The "Due Diligence" file must also include information on the names of the persons empowered to issue instructions to the banks' contracting party (the banks' clients) or on its corporate bodies, as well as on the names of the potential beneficiaries, such as classes of beneficiaries, and even on the name of the curators or protectors, if they have the power to oblige the trustees or the board members of a foundation to dispose of the assets or to change the beneficiaries (CDB 08, Form T, point 4)[7]. Normally protectors should however not have the power to oblige the trustees to disburse funds. The practice in Swiss banks is however too often to include the protectors in the due diligence records even if they have only veto powers. Clients should vigorously oppose this trend.

The "Due Diligence" records are therefore from where the real threat of disclosure of harmful private information originates, because these records exist and can therefore be obtained easily by the Swiss authorities granting administrative assistance to foreign tax authorities, which may lead Swiss authorities to disclose more information than for instance the Isle of Man Authorities classified as a cooperative jurisdiction by the OECD[8]. There is a need for the Swiss banks and their compliance officers to avoid keeping more information than requested by the law and its implementing rules and regulations, including the Due Diligence for Banks as last codified in 2008 (CDB 08). Clients should ask if the Banks' audit procedures include a periodical check to ensure that not more private and confidential information is stored than required by law.

For instance, Swiss banks should not keep detailed information on the protectors in their records, if the protectors cannot order the trustees to dispose of the trust assets in favor of specific beneficiaries but can only approve or refuse a decision of the trustees in this respect. This may mean fighting the well established routine at some banks where they do not make any distinction based on the effective powers of the protectors.

Accordingly, clients of Swiss banks should take measures now to protect their privacy for the future, keeping in mind that the risks arise from three main sources: international assistance including in tax matters, data mining by foreign intelligence and illegal breach of secrecy. This latter remains exceptional, even if we have seen in the recent past that foreign authorities are willing to pay large sums of money to get unauthorized access to confidential client data in some jurisdictions. While Swiss bank secrecy still provides for criminal sanctions against unauthorized disclosures of information, such sanctions are no real compensation for the damage caused by such disclosures, and offers no protection against systematic data mining by foreign states (e.g. analyzing transfers orders from or to their domestic banks when they include a reference to Swiss banks and a link to a domestic taxpayer. The use of powerful software to establish links between taxpayers and international money transfers should not be underestimated in a world where protection of privacy does no longer effectively limit data mining activities by specialized state agencies).

Hide your assets

Numbered or coded Swiss bank accounts are still a means to obtain increased protection against breaches of confidentiality. In practice the name of the account holder is not generally available to the bank's employees in the main computer system, but only accessible by a few staff members. Since this service complicates the bank's internal procedures, this service is normally only available in return for a special fee. Recent developments have not made numbered accounts obsolete, quite to the contrary. But they are no protection against dissemination of confidential information by the clients themselves (the most frequent source of problems), nor against legitimate requests for information by foreign authorities if they can trace funds to or from such confidential account. Clients of banks should not forget that payments made by Swiss banks on their behalf must generally include the name of the account holder (a code name is not sufficient) to comply with international money transfer standards. Therefore numbered accounts cannot be used for international money transfers, or if they are used anyway, the special confidentiality offered within a bank is ipso facto destroyed in the context of the transfer.

[5] *Due Diligence Bank Records contain sensitive data collections within the definition of the Federal Law on Data Protection of June 19, 1992, as amended. Access to such data must be given upon request to the person whose data is being collected. http://www.admin.ch/ch/f/rs/2/235.1.fr.pdf*

The information given must include the origin of the information collected and must give the opportunity to the targeted person to correct the information held in the records. http://www.edoeb.admin.ch/themen/00794/00819/01086/index.html?lang=fr&downlo

[6] *Agreement between the Government and the Federal Republic of Germany and the Government of the Isle of Man http://www.oecd.org/dataoecd/57/5/42262036.pdf*

[7] *Code of Conduct for Securities Dealers governing securities transactions http://www.swissbanking.org/en/801908_e.pdf*

[8] *List of Jurisdictions Committed to Improving Transparency and Establishing Effective Exchange of Information in Tax Matters http://www.oecd.org/document/19/0,3343,en_2649_33745_1903251_1_1_1_1,00.html*

Disclose your assets

Disclosure of formerly hidden assets has been used in the past, and is sometimes a good solution but it offers no protection against confiscatory tax regimes that could be set-up in the future in their home country and some countries have shown in the past that their tax greed is unlimited, so that the estate of a wealthy family cannot be preserved for future generations once it has been declared, if no appropriate measures have been taken before hand[9].

Trusts and Foundations

Offshore companies, used particularly in conjunction with trusts or foundations, are and will continue to be an efficient tool against invasion of privacy via investigations by tax authorities, provided they are used in a legitimate way. It is our experience that this was seldom the case in the past, often because the clients of the banks did not want to incur the related additional legal and accounting costs or because they did not really wish to relinquish direct control over the assets. Only a minority of our clients have accepted to dissociate themselves from their assets in a way compatible with the nature of a true discretionary and irrevocable trust.

Using trusts or foundations in a legitimate way means in practice that no interference by the individual whose assets are transferred into such structures should take place, once the transfer of assets to such structures has occurred[10]. Limited powers to provide guidance as to how to invest the assets or conduct the business of such structures, or even a limited management power to manage the portfolio of such structures, is admissible, as long as such power does not include any right to withdraw or disburse the assets transferred into such a structure.

Furthermore, the trustees of a trust or members of the board of a foundation must not be required to follow instructions by way of a mandate from a third party, as is presently often the case, as this could defeat the very purpose of setting up such structures. This is where the word “TRUST” takes its full meaning. The clients are however protected if their foundation or trust requires the designation of a protector, since that person will need to consent to the main decisions of a trustee. Typically this right includes even the right to appoint a new trustee if necessary.

Local tax advice is necessary to determine the consequences of naming specific individuals as beneficiaries. Making the trust irrevocable and discretionary offers generally a good protection if some other points are also taken into consideration.

A good solution is often to avoid having the “effective” settlor (i.e. the person contributing the assets to the trust) be a beneficiary of the trust. It is also generally a good idea (or even a necessity) to have more than one class of beneficiaries with each class preferably not restricted to a limited list of named individuals since broadening the group of potential beneficiaries will for instance help qualify the trust as a complex trust under US laws (i.e. making it non transparent).

Letter of wishes addressed to the Protector only should not be disclosed before actual payments are contemplated by the Trustees if there is no risk of having the protector loosing them. But in practice the letters of wishes are usually addressed to the Trustees and from there they often end up in the banks due diligence files well before any payment is contemplated, thereby creating a risk of unvoluntary disclosure. More important is therefore to ascertain what information a bank wants before opening or maintaining a banking relation.

There are real differences in the way the banks implement the existing international standards and the resulting legislation and regulations. Many banks request more information than legally required, because there are sanctions only if they have not enough information, not if they jeopardize their clients right to privacy by requesting too much information. Clients should leave banks accumulating excessive information. This is the only sanction at the disposal of clients at the present time against this kind of illegitimate invasion of privacy.

The precise account holding structure and the jurisdiction to be used for protective legal structures depends primarily on the client’s individual needs and circumstances.

Conclusion:

There are no miraculous jurisdictions to preserve the confidentiality in relation to assets held in Swiss banks and clients should be skeptical about advice suggesting to move from one jurisdiction to another. This is seldom “the solution”.

In each jurisdiction there are however service providers that take their duties towards the authorities and their clients more seriously than others.

The above general principles should help the clients select such service providers and will hopefully assist clients of Swiss banks in taking appropriate measures to adjust to the new rules, while protecting their right to privacy.

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[9] *On the subject of the tax greed in the present context Dr. Kondrad Hummler’s comments for Bank Wegelin & Co. in St.Gallen. The Wegelin Investment Commentary No. 264 “States under Stress” http://www.wegelin.ch/download/medien/presse/Wegelin_Investment_Commentary_264_Media_release.pdf*

[10] *Swiss Bank Secrecy Why US taxpayers are more in trouble than others. http://www.stswiss.com/shared/publications/Swiss%20Bank%20Secrecy%20Why%20US%20taxpayers%20are%20more%20in%20trouble%20%20than%20others.pdf*