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Swiss banks and the automatic exchange of tax information: How will it affect Russian residents with Swiss bank accounts?

Switzerland is the world's largest wealth management hub, with 25% of global cross-border assets managed within its mountainous borders. You might have already heard of the automatic exchange of tax information (AEI) – and of how it will affect Swiss bank secrecy¹.

Indeed, Switzerland has pledged to limit its commitment to bank secrecy in tax matters towards non-residents by implementing AEI over the next few years. The first exchanges of information with some foreign authorities about Swiss bank accounts are expected to take place in 2018 with respect to information gathered in 2017. Although no information exchange has been agreed between Switzerland and Russia yet, Russian clients with assets in Swiss bank accounts, whether held in their own name or in the name of legal entities, trusts or foundations that they control or are the beneficial owner of, may also be affected in the future. Also, Swiss banks are increasingly demanding proof of tax compliance from foreign tax resident clients. It is thus important to become informed about such procedures, your rights and obligations and your compliance options in advance.

Finally, other Russian legislation, in particular the Russian law on deoffshorization, already affects Russian residents who control foreign entities. It is also crucial to understand these rules and analyze their consequences on your financial and tax planning.

THE AUTOMATIC EXCHANGE OF TAX INFORMATION (AEI) IS APPROACHING FAST

In the past years, the ultimate goal of the international community, led by the Organization for Economic Cooperation and Development (OECD), has been to improve tax transparency. Over 100 countries have signed the OECD's multilateral agreement on the introduction of the automatic exchange of tax information and have thus committed to implementing AEI in order to reach this goal. Switzerland and Russia have both signed the agreement and made this commitment.

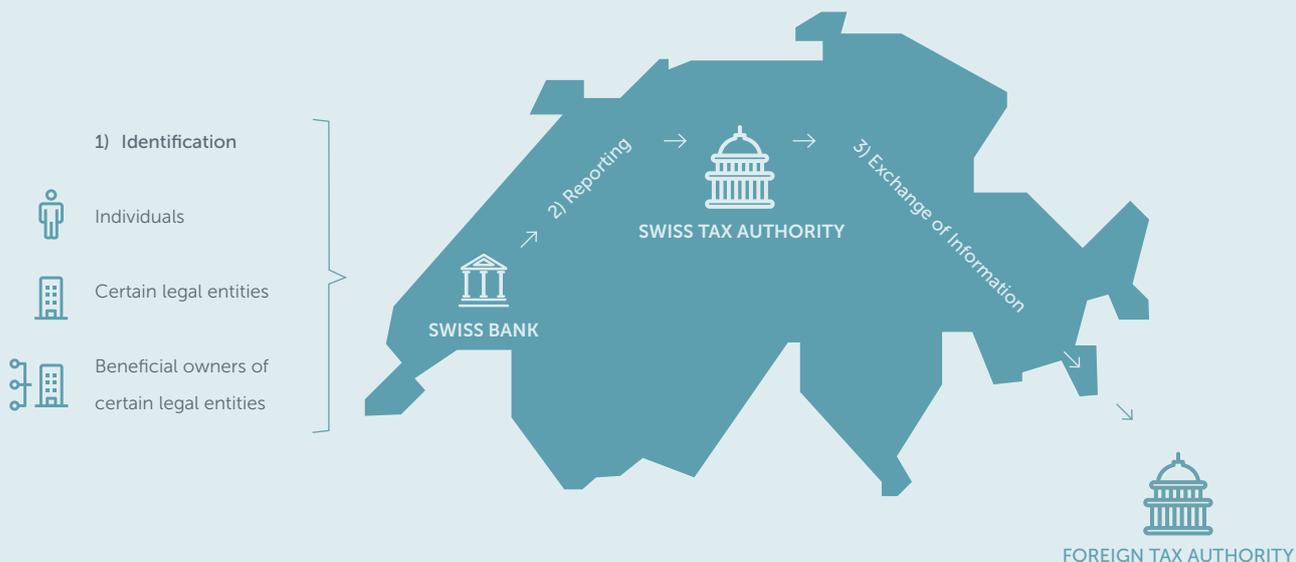
¹ This article is a slightly updated English version of an article that was originally published in Russian in HighClass Magazine No. 22, Autumn/Winter 2016, which is available at: <http://tinyurl.com/hcm-22>.

AEI is an international standard for exchanging information on bank and other financial accounts between tax authorities in different countries. Its objective is to make sure that taxpayers pay the right taxes to the right jurisdiction by exchanging bank information of taxpayers holding assets in financial accounts outside of their country of tax residence. Automatic information exchange is currently the globally accepted standard for international tax cooperation, and AEI is fast becoming a reality in Switzerland and abroad.

However, each country that has signed the OECD's multilateral agreement will only exchange tax-relevant information with other countries with which it has signed an additional, bilateral agreement on such

exchange. Switzerland has signed bilateral agreements with the European Union (28 countries) and 30 other countries so far². Although Switzerland has not signed a bilateral agreement on AEI with Russia yet, such an agreement could be signed at any time in the future.

For this reason, Russian tax residents who have a bank or other financial account in Switzerland may also be affected by these new rules soon. Importantly, AEI aims to deliver information not only on individuals, but also on certain entities, including trusts and foundations, and the persons who control them. Once AEI is implemented, foreign taxpayers will no longer be able to conceal undeclared funds in Swiss banks from their tax authorities. It is thus important to become familiar with the AEI procedure and its consequences now.



How AEI works in Switzerland:

- 1) The bank identifies reportable customers and accounts;
- 2) The bank reports the required information on these accounts to the Swiss Federal Tax Administration;
- 3) The Swiss Federal Tax Administration exchanges the information with foreign tax authorities in states with which Switzerland has signed a bilateral exchange agreement.

² At the time of printing of this article, Switzerland had just signed over 20 new agreements with states and territories such as Brazil, India, Israel, the British Virgin Islands and the Cayman Islands. The agreements will be presented to the Swiss Parliament for approval, and if approved, information exchange with these states is expected to begin in 2019 concerning information collected in the year 2018. Up to 40 further agreements are expected to be signed in the next few months. Information exchange with the EU and 9 other states will begin in 2018 concerning information collected in the year 2017.

HOW DOES AEI WORK IN PRACTICE?

1. WHO IS AFFECTED?

Starting in 2018, financial institutions in Switzerland will be required to report to the Swiss Federal Tax Administration on accounts held by tax residents of countries with which Switzerland had signed an agreement on the exchange of tax information (so called "Partner Jurisdictions"). The reporting financial institutions include not only banks, brokerage and asset management companies, but also certain collective investment vehicles, insurance and trust companies.

Swiss banks are thus required to identify the tax residence of each of their clients. They will then perform due diligence³ on the accounts of clients with tax residence abroad, and, for clients with tax residence in a Partner Jurisdiction, collect certain information about their accounts. Existing bank customers will be contacted if their country of tax residence is unclear from the documentation on hand at the bank. The due diligence obligations for individual accounts are more stringent if the account has a value of over CHF 1 million.

In the case of Russia, Swiss banks will already begin to perform due diligence on accounts held by Russian tax residents in order to identify them and their tax compliance status, even though no automatic exchange of this information is happening yet. The clients affected by these due diligence obligations are, firstly, individuals with tax residence in Russia. These are individuals who spend at least 183 calendar days a year in Russia. Secondly, the due diligence will also seek to identify certain entities with their domicile in Russia and certain foreign entities whose controlling persons and beneficial owners have residence in Russia. Controlling persons and beneficial owners are determined on the basis of various criteria; control can mean share ownership or control through other means, such as a position in senior management. The entities concerned also include trusts, whose settlors, trustees, protectors and beneficiaries are all considered controlling persons, as well as foundations.

2. WHAT INFORMATION IS EXCHANGED, WITH WHOM AND HOW?

When a bank identifies that an account is held by a tax resident of a Partner Jurisdiction, it will gather the following information:

- Identification information (e.g. name of the individual or entity, address, country of tax residence, tax identification number and date of birth for individuals);
- Account information such as the account number; and
- Financial information (e.g. account balance and gross income from dividends, interest and other revenue).

Swiss banks will be required to take this "snapshot" of the accounts of residents of Partner Jurisdictions annually, for the first time in 2017. Then, each bank will report the relevant information annually, for the first time in June 2018, to the Swiss tax authorities, who will forward the data to the tax authorities of Partner Jurisdictions in September of each year.

As mentioned above, Switzerland and Russia have not yet signed a bilateral agreement to conduct AEI, and exchange will most likely be implemented after 2018. However, for practical purposes, Swiss banks will be performing due diligence on all their foreign resident account holders in 2017, including those from Russia, in order to ascertain their clients' effective tax residence. Swiss banks are also increasingly demanding that their clients prove that they are tax compliant in their countries of residence.

And if a bilateral agreement is signed in year X, for example, it is possible that information exchange would begin in year X+1 and would already concern information from year X. Careful clients will thus anticipate such changes and plan in advance.

³ In the context of this article, "due diligence" means the banks' examination of their clients' accounts, including identifying the beneficial owners of such accounts if the account is held by certain types of entities, and their tax compliance status.

3. WHAT ARE YOUR RIGHTS, AND WHAT SHOULD YOU DO BEFORE AEI BEGINS?

It is important to know that Swiss banks will be performing due diligence on your accounts – both on accounts in your own name and in the name of legal entities you control – starting in 2017. It is also important to know your rights in any future AEI proceedings and to assert these rights. You, as an account holder, have a right to know what information was transmitted to the Swiss tax authorities. You also have a right to the correct determination of your tax residency and your status of beneficial ownership, as well as to the correct transmission of your information to the tax authorities by the bank. You can assert these rights in court if necessary.

Now that the deadline for the voluntarily declaration of foreign bank accounts to the Russian authorities and benefiting from tax amnesty has passed, relocating to a third country might be an option for some clients. However, transferring assets from Switzerland to another jurisdiction where AEI is not yet on the radar is not a recommended solution, as AEI is approaching fast in most countries around the world. In any case, Swiss banks will not assist their clients in evading tax liability and may block an account or inform the authorities about the destinations to which assets have been transferred.

Russian law foresees administrative and criminal penalties for tax evasion and abetting tax evasion in Russia. You could be subject to a fine of 20% of the evaded tax, rising to 40% in case non-payment of taxes was deliberate. Getting your affairs in order and becoming tax compliant is thus of the utmost importance.

And even before AEI begins, another issue may affect Russian clients: so-called group requests. These requests are based on already existing double taxation treaties and are made by foreign tax authorities to the Swiss tax authorities in order to obtain information about a group of customers of a Swiss bank.

Russia and Switzerland have a double taxation treaty that allows group requests, and even though “fishing expeditions” are not permitted, the Swiss Supreme Court interprets the permissibility of group requests broadly. For example, a group request submitted by the Netherlands and covering the period from 1 February 2013 to 31 December 2014 was recently approved by the Swiss Supreme Court. The request concerns clients residing in the Netherlands during the time frame indicated, whose names are unknown to the Dutch authorities and who had not proven to their Swiss bank that they were tax compliant in the Netherlands. This shows the scope of a potential group request concerning Russian clients and also suggests that banks will increasingly demand proof of tax compliance to start or maintain a relationship with a foreign client.

Group requests by countries such as Spain and France are now pending, and other countries may follow suit. Russian account holders have rights and obligations in possible group request proceedings, as well, and can also assert their rights in court.

THE NEW LAW ON DEOFFSHORIZATION AND ITS EFFECTS ON RUSSIAN RESIDENTS

The past few years have been tumultuous ones for Russia’s tax and legal landscape. A new Law on Deoffshorization has been enacted in order to encourage Russian tax residents to move their offshore assets back to Russia.

One important part of the new regulations are obligations for Russian tax residents to report, on the one hand, their participations in foreign companies, and on the other hand, their Controlled Foreign Companies (CFC). These are foreign companies that are not tax residents in Russia but are controlled by individuals or entities that are Russian tax residents.

CFCs must be declared in Russia, and their profits are taxed in Russia independently of whether they are distributed to the controlling Russian tax resident or not. Russian tax residents who fail to declare CFCs are subject to a fine, and failure to pay taxes on the profits of a CFC is generally subject to a fine of 20% of the sum of the evaded taxes. Criminal penalties may also apply.

Moreover, Swiss banks are beginning to request evidence of compliance with Russian CFC rules from their clients, including requesting proof of declaration of the CFC in Russia if an account is held in the name of a foreign entity or a structure, such as a trust or foundation, whose beneficial owner is subject to Russian CFC rules.

Clients with CFCs may be asking themselves what they can do. One option is liquidation, as certain types of CFC liquidation proceeds are not taxable if the liquidation is completed before 1 January 2018. In some cases, if the decision to liquidate is taken before 1 January 2017, the liquidation may be completed after 1 January 2018. The rules on CFCs are complex and the status of each foreign entity, whether it must be declared, whether and how it will be taxed and possible solutions must be evaluated on a case-by-case basis.

FINDING THE RIGHT SOLUTIONS TO BECOME COMPLIANT – TIME TO TAKE ACTION

The legal landscape for Russian clients holding Swiss bank accounts or foreign entities which, in turn, may hold a bank account in Switzerland, is extremely complex. That said, since it is perfectly legal for Russian tax residents to hold a bank account (either in your own name or in the name of an entity) in Switzerland or to hold shares in or manage a foreign entity, those taxpayers who are tax compliant in Russia will, when AEI is implemented, have no problems when their information is collected and transmitted.

However, Russian taxpayers who are not certain to be compliant should take appropriate action now. If you hold undeclared assets in any form of financial account in Switzerland, it will be important to identify whether the account is considered a reportable account for the purposes of AEI. After identifying your status, solutions for regularizing it can be considered.

If you hold shares in or otherwise participate in or manage a legal entity with its seat outside of Russia, it should be examined whether the entity is a reportable entity and you are considered a controlling person under Russian CFC rules. After identifying your status, possible solutions, among them reporting or liquidation, can be considered depending on your circumstances.

Please note that this article is of a purely general and informative nature and that each client's case is different. Altenburger Ltd legal + tax can draw on many years of expertise in banking and tax law. The attorneys and legal staff at our Zurich, Geneva and Lugano offices have the knowledge and understanding to help you learn more about your legal situation and address your needs for tax-compliant solutions.

BUSINESS RUSSIA - SWITZERLAND

The Business Russia - Switzerland Team of Altenburger, led by Cyril Troyanov, provides legal and tax advice and services to clients having interests in Russia and Switzerland. Our team has expertise in a wide range of practice areas, such as corporate/M&A, tax, banking and finance, labor law, real estate and immigration, as well as all kinds of dispute resolution.

Altenburger Ltd legal + tax works in close cooperation with Secretan Troyanov Schaer, a Swiss-Russian law firm established in Moscow since 1992. The two teams also maintain excellent relationships with other law firms and service providers world-wide who are experienced in dealing with Russian and Swiss-related issues.

Due to our combined legal and tax expertise in many areas, our foreign language skills and our dedicated teams of professionals in all three main language areas of Switzerland, we are well-positioned to render efficient cross-border legal and tax advice and serve the needs of clients seeking international advice and services in Switzerland and Russia.

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