

Switzerland's Tax Cooperation Agreements With the U.K. and Germany

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PRACTITIONERS' CORNER

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Switzerland signed bilateral agreements with Germany on September 21, 2011, and with the United Kingdom on October 6, 2011. Since then, the agreements — which aim to tax individuals resident in Germany or the U.K. who hold deposits in Switzerland, while protecting Swiss bank secrecy — have been under EU scrutiny.

The European Commission said the signed agreements were incompatible with the EU savings tax directive, on which the EU and Switzerland also signed a bilateral agreement in 2004. In response to the commission's concerns, Germany and the U.K. revised the agreements.

On March 20, 2012, Switzerland and the U.K. supplemented the tax agreements by a protocol and amendment agreements. A few days later, on April 5, Switzerland and Germany signed a supplementary protocol. These protocols address the commission's concerns regarding the protocols' compatibility with EU law.

In a previous article on Switzerland's tax cooperation agreements with the U.K. and Germany, we described how the past is regularized under the agreements.¹ This article focuses on the new protocols'

changes regarding the regularization of the past and on the future taxation of investment income.

Changes Introduced by the Protocols

The protocols signed by Switzerland and the contracting states do not change the agreements in their essence. Nonetheless, the protocols include substantial changes in content with the effect that those changes will not be undervalued for U.K. and German bank clients.

Specifically, interest payments are no longer included in the agreements' scope. This is because of the commission's concerns that the tax agreements between Switzerland and Germany and the U.K. include the taxation of interest payments, even though interest payments are already covered by the existing Agreement on the Taxation of Savings Income Between Switzerland and the EU (the EU savings tax agreement), which entered into force on July 1, 2005.

Consequently, interest payments are excluded from the scope of the agreements. However, nothing changed effectively for the bank clients — only the legal structure changed. The future taxation of U.K. and German taxpayers' interest income is no longer based on the newly concluded bilateral tax agreements, but the EU savings tax agreement signed by Switzerland and the EU removed the commission's concerns regarding compatibility with EU law.

However, the taxation of interest income according to the EU savings tax agreement does not lead to a uniform tax burden for U.K. and German residents.

¹See Leonard Toenz and Katja Krech, "Switzerland's Tax Cooperation Agreements With the U.K. and Germany — Regularizing the Past," *Tax Notes Int'l*, Mar. 5, 2012, p. 757, *Doc 2012-2431*, or 2012 *WTD* 43-18.

Under the agreement with Germany, a retention tax of 35 percent is levied. In the case of disclosure (see below), the difference between the originally agreed-upon tax rate of 26.375 percent and the retention tax of 35 percent will be refunded. In contrast, under the agreement concluded with the U.K., a final payment amounting to 13 percent is to be paid in addition to the retention tax of 35 percent. Effectively, the original tax rate of 48 percent according to the agreement with the U.K. remains.

The most considerable change introduced by the protocols is that the taxation of inheritances (but not gifts) is now covered by the agreements. Inheritances will be covered after the agreements come into force. Heirs must consent to either collection of a tax or disclosure. The marginal tax rate will be 50 percent if the decedent was last a resident in Germany, and 40 percent if in the U.K.

Regarding the regularization of the past, the U.K. and Germany concluded different supplements to increase the size of the tax burden. Instead of being between 19 and 34 percent under the original agreement, the tax rate is now between 21 and 41 percent. Under the original formula, the tax rate applied in a specific case would have been 34 percent, but the tax rate will now increase by 1 percentage point for each additional €1 million in relevant assets, up to a maximum of 41 percent.

The Switzerland-U.K. protocol introduces a most favored nation clause allowing the U.K. the same benefits of the Germany-Switzerland protocol. The original marginal tax rates have not been amended for U.K. persons, but the most favored nation clause gives the U.K. the right to have any beneficial changes in the operation of the formula that calculates the one-off payment for the past agreement between Switzerland and Germany incorporated into the U.K. agreement. Therefore, the minimum rate payable will increase from 19 percent to 21 percent. If the taxpayer has £7 million or more assets in a Swiss bank account, a maximum tax rate of 41 percent will apply.

Persons affected by the treaties, known as "relevant persons," must have residency in the U.K. or Germany and be a contractual partner of a Swiss paying agent (account or deposit holder and beneficial owner of the assets).

Originally, the relevant person had to be resident as of December 31, 2010, and had to be under contract with a Swiss paying agent from December 31, 2010, to May 31, 2013, under both agreements.

The Germany-Switzerland protocol advances the deadline from May 31, 2013, to January 1, 2013. That means that German taxpayers will no longer be able to shift assets from Switzerland to third countries without notification after the agreement enters into force on January 1, 2013. However, the dates remain unchanged under the U.K. agreement; U.K. taxpayers may transfer assets out of Switzerland through May 31, 2013.

Also, the number of possible requests for information has been increased to a maximum of 1,300 within a two-year period under the agreement with Germany. This option extends and supplements the exchange of information according to the OECD standard.

Future Taxation of Investment Income

Under the agreements concluded by Switzerland with Germany and the U.K., a relevant person's future investment income can be taxed in two different ways:

- payment of the final withholding tax levied by the Swiss paying agent; or
- voluntary disclosure to the German or U.K. authorities.

Because the taxation choice has no impact on the above-noted options available for the taxation of future income and gains on relevant assets, the relevant person might opt for a voluntary disclosure to regularize the past and choose the final withholding tax for the future.

Besides these two options, the agreements provide for a third option regarding the taxation of interest income: The taxpayer may choose to apply the rules provided under the EU savings tax agreement. This option arises from the concerns of the commission regarding the taxation of interest payments under the original tax agreements. Consequently, a carve-out has been introduced by the protocols. Under the EU savings tax agreement, a relevant person can again opt either for a final withholding tax or a voluntary disclosure.

Final Withholding Tax

If the relevant person does not expressly authorize the Swiss paying agent to disclose to the U.K. or German competent authorities the income that has been earned and the capital gains that has been realized on a Swiss account or deposit, the Swiss paying agent will levy a final withholding tax on relevant assets.

The applicable withholding tax rates are based on the local tax law of the contracting states. No uniform tax rate has been implemented by the agreements.

According to the agreement with Germany, the rate amounts to 26.375 percent and applies for each type of investment income (except interest covered by the EU savings tax agreement) on assets held by an affected person resident in Germany. Interest income covered by the EU savings tax agreement will be taxed at the rate of 35 percent. In the case of disclosure, the difference of 8.625 percent will be refunded.

In contrast, the agreement with the U.K. includes a variable tax rate depending on the type of investment income:

- 40 percent on dividend income;
- 48 percent on interest income; and
- 27 percent on capital gains.

These tax rates are equivalent to the tax rates for U.K. income tax.

The Swiss paying agent must levy the withholding tax in sterling and in euros (depending on the applicable agreement). The withholding tax is levied anonymously, so the privacy of the bank's client will be protected.

Although the Swiss paying agent levies the tax, the relevant person is still the party liable for withholding tax.

When withholding tax is levied in accordance with the agreements, the relevant person will cease to have any liability for German and U.K. taxes, including interest, penalties, and surcharges that are chargeable on the income and gains falling within the provisions of the agreements. This means that the relevant person doesn't have any further income tax liability, including solidarity supplement and church tax in Germany.

The Swiss paying agent must issue to the relevant person a certificate in the form prescribed at the end of each tax year and when the banking relationship is ended. The competent authorities of the contracting states must accept the certificate issued by the Swiss paying agent as sufficient evidence of payments of withholding tax.

Because different tax rates may apply on each type of investment income, the definitions of the terms are fundamental. Some terms are defined in the agreements (for example, interest income, dividend income, other income, and capital gains). Further, the agreement with Germany includes a concordance that governs the tax-related treatment of securities events. Also, the Federal Act on International Withholding Tax (IWTA) will implement the new agreements in Switzerland. This act contains provisions on organization, procedure, judicial channels, and applicable criminal law provisions. The detailed requirements for implementing the withholding tax will be drawn up in guidelines by the Swiss Federal Tax Administration (SFTA) together with the paying agents, industry associations, and financial information company SIX Telekurs. The guidelines include provisions concerning the implementation of the corresponding concordance tables. However, the guidelines have not been completed and are not yet open to the public.

Voluntary Disclosure

Taxpayers can also avail themselves of the Swiss paying agent disclosing their income to the tax authorities of the contracting state.

The relevant person must notify the Swiss paying agent in writing, and the bank must report the income earned and capital gains realized on the account or deposit to the SFTA, which will forward the account information to the competent authority of the contracting state.

The disclosure will include the following information:

- identity (last name, first name, and date of birth) and address of the relevant person;
- tax identification number, if known;
- name and address of the Swiss paying agent;
- customer number of the account or deposit holder (customer, account or deposit number, international bank account number);
- tax year concerned;
- total amount of income as defined under the provision concerning the final withholding tax; and
- total amount of capital gains and losses realized as calculated in accordance with the agreements.

The Swiss paying agents must transfer this information to the SFTA no later than three months after the end of the tax year. The SFTA must communicate this information once a year within a period of six months following the end of the tax year to the competent authority of the contracting state.

Because no withholding tax is levied in a voluntary disclosure, the relevant person must declare the income derived from Swiss bank or deposit accounts in the tax return filed with the tax authorities in the contracting state.

Information received by the competent authority of the contracting state as a result of voluntary disclosure made by a relevant person may be used not only for the assessment or collection of, the enforcement or prosecution in respect of, the determination of appeals, or the oversight of the above in relation to taxes and tax matters, but also for other purposes. This means that information reported under voluntary disclosure can be used for all purposes, including for a request made under the information exchange clause under the income tax treaty between the contracting states. Time will tell what this will lead to.

Inheritance

Based on the U.K. and German agreements, inheritances will be covered after the agreements come into force.

When a Swiss paying agent becomes aware of the death of a relevant person, the agent must freeze the relevant person's bank account. The heirs must consent to the collection of a 50 percent tax for decedents who last resided in Germany, a 40 percent tax for decedents who last resided in the U.K., or to disclosure.

If the heirs do not give the Swiss paying agent a written authorization to make a disclosure within one year from the date of the relevant person's death, the bank will withhold an amount at the applicable tax rate of the relevant assets booked at the date of the relevant person's death.

When there are insufficient funds to withhold the full amount of the tax, the Swiss paying agent is

obliged to make a disclosure as if the heirs have provided written authorization, provided that they have not made available the necessary funds within a period specified by the bank, not exceeding eight weeks.

After withholding the tax or making the disclosure, the Swiss paying agent must issue a certificate to the heirs in the form prescribed.

After the tax is withheld, the heirs cease having any inheritance tax liabilities in the contracting state for the relevant assets at the date of death of the deceased, including interest and penalties. Any other tax liabilities of the deceased person in the U.K. or Germany, including liabilities to tax on income or gains, are not affected by the withholding of the inheritance tax.

Entering Into Force

The protocols require parliamentary approval in both states.

On April 18, 2012, Switzerland's Federal Council released the submission to the parliament on the withholding tax agreements with the U.K. and Germany and, furthermore, on the IWTA. The Swiss parliament approved the agreements and the IWTA during the recent summer session (May 29-June 15, 2012).

In Germany the tax agreement faces vehement resistance by state representatives. It is unclear whether the agreement will be adopted.

It is expected that the agreements with the U.K. and Germany and the IWTA will enter into force on January 1, 2013. ◆