The UK – Swiss Agreement on bilateral tax matters (‘Rubik’ flat rate withholding tax) and its consequences for UK resident clients of banks in Switzerland

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As part of the only US and UK tax consultancy firm in Switzerland, Jason Gyamerah and his colleagues at US Tax & Financial Services Sárl have been at the forefront of advice and comment in respect of the recent developments in this new era of tax transparency faced by Swiss Banks, Trustees and other Fiduciaries. With the added benefit of physical presence in both Geneva and Zurich, US Tax & Financial Services, Sárl is considered the first port of call for advice on all aspects of UK and US taxation, especially where disclosures to HM Revenue & Customs or the IRS are a consideration

This article reviews the recent background to the UK-Swiss Agreement in the context of Switzerland’s economic and political circumstances, which will go some way to explain the huge change in the banking sector’s attitudes towards tax compliance over the last three years. The paper then goes on to analyse the details of the agreement, its immediate costs and consequences to the client and how it will be implemented. Most importantly, it reviews what the clients choices are, both in relation to the agreement itself and the alternative option - which is widely regarded as less onerous and more secure - offered by disclosure under the LDF.

I. Recent history & background to the UK-Swiss agreement

The Swiss banking sector contributes circa 6.7% of the nation’s gross domestic product and is therefore an important contributor to the country’s prosperity. With around 10% of the country’s tax revenues and 142,000 skilled jobs in Switzerland attributed to the banking sector, the “legitimate protection of clients’ privacy in financial matters is an important factor in this success”. According to the Swiss Banking Association (SBA):

“Switzerland has therefore made strong efforts to prevent abuse at the international level by means of international administrative and judicial assistance processes and cooperation based on multilateral and bilateral agreements, such as the recent adoption of the OECD DTA Article 26 standard. The Swiss banks have consistently supported Switzerland in these efforts and implemented the corresponding measures.

A variety of problems and issues have arisen in the cross-border banking business in recent years that jeopardise important political and economic bilateral relations. In response to these developments, the Swiss Bankers Association has promoted the *2015 Financial Centre Strategy* since 2009.”

This strategy is based on the following four pillars:

1. **Retention and strengthening of client trust through regularisation**

   Given the trust that foreign clients have in the Swiss legal system and the fiduciary responsibility exercised by the Swiss banking sector, the regularization of untaxed assets in Switzerland is at the heart of any future solution with foreign tax authorities.

2. **Future focus of Swiss banking sector on attracting taxed assets**

   The sector's focus is to be concentrated on the acquisition and management of taxed assets from foreign clients. This approach is supported by the adoption of the global standard of Article 26 of the OECD Model Double Taxation Agreement, which provides for administrative assistance on a case-by-case basis for all tax offences where there is legitimate suspicion.

3. **Protection of privacy remains key**

   The retention of the protection of client privacy is a central aspect of the Swiss legal approach, while making it possible for action to be taken to combat or prevent all tax offences.

4. **Growth and market access**

   A strong banking sector is central to the continued growth of the Swiss economy. A prerequisite to this growth is an improvement in the sector's competitiveness with other international financial centres. At the international level, other countries must respond in kind to the flat rate tax model by improving market access for financial services from Switzerland and reducing existing bilateral discrimination.

In December 2009, the Swiss Banking Association (SBA) issued a proposal document simply titled "*Project Flat Rate Tax*" with a view to outlining Switzerland's potential approach to resolving various challenges facing Swiss banking institutions in dealing with the issue of tax transparency within the international environment. The aim of this project was to ensure that assets of foreign domiciled clients of Swiss banking institutions are compliant with respect to the tax laws of the client's tax domicile. A parallel goal of this proposal was also to preserve "the legitimate protection of clients' privacy in financial matters", which is generally accepted as one of the overriding contributing factors to the success of the Swiss banking sector. The stated objectives of the SBA's Flat rate Tax proposal were:

- The application of a flat rate tax with a prospective effect and protection of privacy: the taxation of the investment income of foreign domiciled clients is defined with treaty states receiving the full amount of tax owed immediately and the preservation of clients' financial privacy guaranteed long-term
- Possible flat rate tax with retroactive effect: the incorporation of a flat rate tax with retrospective effect (depending on the requirements of the relevant foreign jurisdiction). Alternatively, the assets of certain clients would be decriminalised after expiry of the limitation periods
- In return, Switzerland would be guaranteed "undiscriminated access" to the financial markets of the foreign jurisdiction on the basis of their national laws

The crystallization of the aims and objectives of the Swiss banking sector, as outlined in the 2015 Financial Centre Strategy and Project Flat Rate Tax were embodied in the signing of the "Rubik" bilateral agreements with the United Kingdom and Germany respectively during 2011.

II. Scope of the Rubik agreement: "relevant assets & persons"

On October 6th 2011 the UK Government signed a tax agreement with Swiss authorities regarding the regularisation of existing untaxed assets and introduction of a final withholding tax on future income. The scope and purpose of the agreement was "...to ensure the effective taxation in the United Kingdom of relevant persons..."

An additional intention of the agreement was that it will achieve the level of cooperation between the UK and Switzerland in respect of the taxation of income and gains on relevant assets equivalent to the outcome that would be achieved through an automatic Exchange of Information Agreement.

The objective of the agreement was for the UK and Swiss authorities to provide assistance to each other in respect of:

- The tax regularisation of relevant assets held in Switzerland by or for relevant persons
- The effective taxation of the income and gains on relevant assets held in Switzerland by or for relevant persons
- Further exchange of information by the UK to ensure the effective taxation of Swiss residents regarding assets in the UK

The requirements of the agreement will come into force on January 1st 2013 but the ultimate deadline for the computation and deduction of withholding tax by the banks is 31st May 2013.

Relevant Assets and Relevant Persons

Under the terms of the Agreement, the requirements placed on the Swiss banks are to be applied to "*relevant assets*" held by or for "*relevant persons*". In this case, UK residents who are "*beneficial owners*"). To assist Swiss banks in navigating the terms of the agreement, the related Protocol defines relevant assets and relevant persons as:

Relevant asset: All forms of bankable assets booked or deposited with a Swiss financial institutions including (but not limited to):

- Cash accounts and precious metals accounts
- Bankable assets held by a Swiss paying agent acting as a fiduciary agent
- All forms of stocks, shares and securities
- Options, debts and forward contracts
- Other structured products traded by the banks such as certificates and convertibles

For the purposes of the Agreement the following are **NOT** be regarded as relevant assets for:

- Contents of safe deposit boxes
- Real property
- Chattels
- Insurance contracts which are regulated by the Swiss Financial Market Supervisory Authority, with the exception of assets held by an insurance company in an account separate from the insurance company's main accounts combined with a minimal risk protection and where the pay-out or redemption is not restricted to death, disability or illness (hereinafter referred to as "insurance wrappers")

Relevant person: An individual resident in the United Kingdom, who is:

- The account holder or deposit holder and beneficial owner of assets; or
- Is identified by the Swiss financial institution, in accordance with the Swiss due diligence obligations, as the beneficial owner of assets held by:
    - A domiciliary company (i.e. legal entities, companies, institutions, foundations, trusts, fiduciary companies and other establishments not exercising a trading or manufacturing activity or another form of commercial operations); or
    - An insurance company in an "insurance wrapper"; or
    - Another individual by means of an account or a deposit with a Swiss financial institution

A domiciliary company is considered to be the beneficial owner if it is itself subject to effective taxation under the general rules for direct taxation applicable under the law of its place of establishment or its place of effective management, or if it is treated as non-transparent under UK law.

An individual resident in the UK is not considered to be a relevant person with regard to assets of associations of persons, asset structures, trusts or foundations if it is not possible to ascertain the beneficial ownership of such assets, e.g. due to the discretionary nature of the arrangement.

The beneficial owner of an insurance wrapper is not considered a relevant person, where the insurance company confirms to the Swiss financial institution that it will deliver the appropriate certification to the relevant UK authority.

III. Implementation of the Agreement:

Under the terms of the Agreement all financial institutions in Switzerland are required to comply with the requirements and their responsibilities as laid out in the terms of the Agreement. This effectively results in the Swiss financial institutions acting as withholding and reporting agents for the Swiss Federal Tax Administration (SFTA), which will then liaise with the UK tax authorities.

The implementation of the agreement has put two requirements on Swiss banks as follows:

- **Historical tax liabilities**:
    - Bank accounts open between 31 December 2010 and 31 May 2013 and held by individual UK taxpayers will be subject to a one-off levy of between 21% - 41% (25% on average) on the value of the bank account. The value on which the levy will be applied is dependent on the length of time the assets within the account have been located in Switzerland. This is in lieu of the historic tax liabilities, interest and penalties that may apply. No further liability (including interest, penalties and surcharges) to UK IT, CGT, IHT or VAT, arising prior to the date of the Agreement coming into force, in

respect of the Swiss asset. However, this will have to be agreed with HMRC. Note that the Agreement does not cover liabilities to other potential UK taxes such as CT, PAYE, and NIC.

- **Future Withholding**
  - From 2013 withholding tax will be automatically applied on income and gains derived from Swiss bank accounts of 48% and 27% respectively. Dividend income will be subject to a 40% withholding tax. Interest amounts that are subject to EU-Savings Tax are excluded from withholding
- **Notification**
  - Under the Agreement Swiss banks are required to notify customers as to the impact of the agreement on them, their obligations and rights. The levy and withholding tax can be avoided by the taxpayer giving his consent to the disclosure of data to HMRC.
- **Non-domiciled individuals**
  - The terms of the Agreement include specific provisions relating to individuals who are UK resident but not UK domiciled ("RND"). These provisions mean that the potential benefits of RND status are as follows:
  - Historical tax liabilities: RNDs have the following two additional options:
    1. Submit a self-assessment of any unpaid UK tax liabilities to HM Revenue & Customs; or
    2. Opt out of the one-off levy
  - Future Withholding: Future withholding tax will only be levied on income or gains which have arisen form a UK source and/or any income and/or gains that are remitted to the UK (i.e. income and/or gains brought to, received or used in the UK).

The above benefits can only be achieved by the individual providing certification of their RND status to the relevant Swiss bank. This certification must be provided by a lawyer, accountant or tax advisor who is a member of a relevant professional body. The certification must verify that:

- The relevant person's UK tax return for the relevant tax year includes a claim or statement that the relevant person is not domiciled within the UK
- Where appropriate, a remittance basis claim has been made
- To the best of the knowledge of the professional signing the certificate, the domicile status of the relevant person is not formally disputed by HMRC

The certification must be supplied to the Swiss bank within the following applicable time periods:

- Historical tax liabilities (one-off levy): The RND will need to submit a certificate to their Swiss bank by 31 May 2013
- Future withholding tax: the RND will need to provide the Swiss bank with:
  1. A declaration of intent to claim the remittance basis of taxation for the following tax year
  2. A certificate of non-UK domicile by 31 March following the end of the relevant tax year

"The requirements of the agreement will come into force on January 1st 2013 but the ultimate deadline for the computation and deduction of withholding tax by the banks is 31st May 2013."

IV. Decisions required by client: options under the UK/Swiss Agreement:

- **Option One***:
  - Suffer anonymous one-off levy (and future withholding) in respect of relevant asset(s)
- **Option Two***:
  - Authorize disclosure of the income and gains arising on relevant asset(s) to Swiss authorities:
    - Result – Swiss authorities will disclose: identity, UK tax reference, name/address of Swiss bank, account number, UK tax year concerned and details of income and gains arising on relevant asset to HMRC
- **Option Three**:
  - Make a voluntary disclosure to HMRC and consider using the Liechtenstein Disclosure Facility (LDF) – (penalties limited to 10% of tax due).

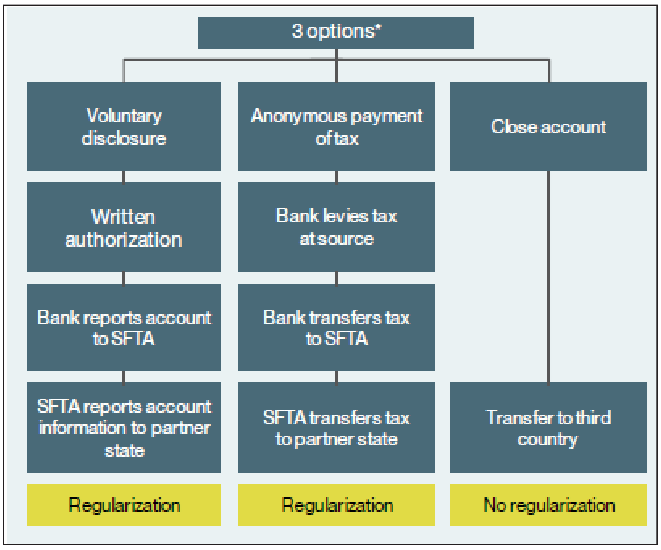

*Table Source: CAPCO.COM

*NOTE: The use of options One and Two above do not ensure complete UK tax compliance as any disclosure under these options can only apply to Swiss situs assets and benefit for the withheld amounts can only be obtained via a future disclosure to HMRC. There is also a potential risk that authorization of a disclosure under option Two may lead to a potential HMRC enquiry/investigation.

- **Option Four**:

Make a voluntary disclosure to HMRC other than under the LDF – (potential penalties of 30% to 150% of tax due in respect of Swiss assets)

- **Option Five**:
  - Move relevant assets to another jurisdiction.
    - **Result** – One-off levy will not be applied if assets moved prior to 31 May 2013 – This may only defer the UK tax issue. Swiss authorities will inform HMRC of the top 10 destinations to which assets have been moved
    - **Risk**:
      - HMRC are actively pursuing similar agreements with other jurisdictions and have increased resources to combat tax evasion. Potential increased tax liabilities, higher penalties of up to 200% than if taxpayers make a voluntary disclosure or use the Swiss Agreement
      - Increased potential for criminal prosecution
      - Potential intrusive HMRC investigation and associated costs if HMRC contact a taxpayer prior to the Swiss Agreement coming into force

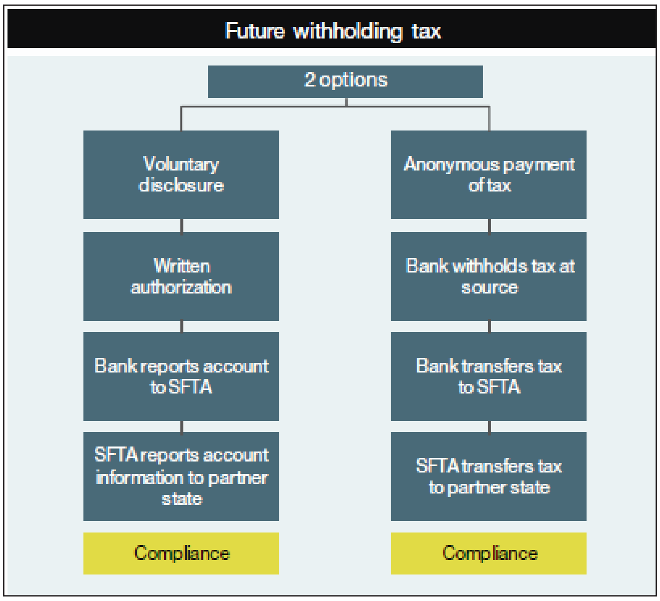

*Table Source: CAPCO.COM

V. Comparison with Lichtenstein Disclosure Facility (LDF)

Background and development of LDF

In August 2009 an historic agreement between HM Revenue & Customs ("HMRC") and the Government of the Principality of Liechtenstein was annouced to provide for the introduction of a five year UK taxpayer assistance and compliance programme via a special disclosure facility, the Liechtenstein Disclosure Facility ("LDF"). The agreement is widely regarded as one of HMRC's most purposeful initiatives to increase the tax compliance of certain UK residents. This initiative was a result of what some are calling a "perfect storm" of events including:

- The theft of personal data in relation UK citizens holding assets that in some cases were untaxed in the UK
- The increasingly difficult economic climate brought on by the 2008 banking and financial crisis
- The increased cooperation between tax authorities of different jurisdictions resulting in a number of Tax Information Exchange Agreements ("TIEA") which enable countries to share and exchange information on their taxpayers

On August 11th 2009 the UK and Leichtenstein signed a TIEA and Memorandum of Understanding ("MOU") supported by a subsequent Joint Declaration. The purpose of the MOU and Joint Declaration was to set out the agreed actions of both countries and included the details of the LDF.

Overview of the Liechtenstein Disclosure Facility

- The LDF allows individuals with unpaid UK taxes relating to previously undisclosed income or capital gains linked to offshore accounts and assets held in the Principality of Liechtenstein to settle related tax liabilities and late payment interest charges and penalties
- The terms of the LDF also provide for its use by those UK taxpayers who do not have an existing asset in Liechtenstein provided they do have such an asset at the time of registering with HMRC for participation in the LDF and they held an offhsore asset (worldwide) on 1st September 2009
- The LDF provisions apply to all UK Resident and/or certain non-UK Domiciled individuals who have any interest in a "Relevant Asset" operated and/or managed in the Principality of Liechtenstein (i.e. Accounts, Trusts, Regulated Trusts, Stiftungs, Foundations, Anstalts or Corporate entities) and would otherwise be subject to UK tax
- Wth effect from 1st September 2012, those wishing to particpate in the LDF are required to confirm a "Meaningful Relationship" with Liichtenstein to the relevant Liechtenstein Financial Intermediary (FI) so that in turn the FI issues the required Certificate of Relevance to enable participation in the LDF. In July 2012 the Leichtenstein Government issued an amendment to the terms of the original LDF agreement via the UK TIEA ordinance. The intended purpose of the amendment is to enable new long term relationships to be established with the Liechtenstein Financial Centre
- The amendment defined a "Meaningful Relationship" by establishing the following thresholds of the materiality of a business relationship:
  - Banks: At least 20% of the worldwide undisclosed bankable assets (or CHF3 million) that are to be registered for participation in the LDF must be held in Liechtenstein
  - Trust Company: At least 10% of the undisclosed worldwide bankable assets (or CHF1 million) that are to be registered for participation in the LDF must be held in Leichtenstein
  - Legal Entity domiciled abroad but managed in Liechtenstein: At least 15% of the undisclosed worldwide bankable assets (or CHF1 million) that are to be registered for participation in the LDF must be held in Liechtenstein
  - Insurance Company in Liechtenstein: a policy with a minimum premium of CHF150,000
- The provisions of the LDF were implemented on 1st September 2009 and the facility will continue until 2016 (extended from 2015) unless the individual is notified directly by a Liechtenstein Financial Institution, in which case other time limits will apply. The time limit for particpation in the LDF is more generous than that of previous HMRC disclosure initiatives but, nevertheless,

any delay may increase the penalty charges if the disclosure is made outside of the LDF or HMRC initiate an enquiry/investigation into the individual's affairs

- Generally, HMRC's powers allow them conduct enquires for periods going back as far as 20 years in circumstances where the individual's UK tax non-compliance is suspected to have been deliberate. Under the terms of the LDF, HMRC limits the assessment period to tax years beginning 6th April 1999 onwards (or accounting periods from 1st April 1999).
- Where resulting additional tax arises from innocent error or carelessness the disclosure period is limited to four or six years respectively
- Under the provisions of the LDF, an individual may be able to claim immunity from criminal prosecution if the disclosure includes a full declaration of their previously undeclared worldwide assets and income held offshore. This amnesty will apply if any income tax, capital gains tax, inheritance tax etc. outstanding is paid in full together with additional interest and penalty charges. Outside of the LDF, ordinarily HMRC can, in extreme cases, apply a penalty of 200% of the tax outstanding and recommend criminal prosecution leading to a conviction and a possible sentence of up to seven years imprisonment

Tax, interest and beneficial penalty rates of the LDF

- Particpation in the LDF provides for settlement of all UK taxes including (but not limited to) Income Tax, Corporation Tax, PAYE, Capital Gains Tax, VAT and Inheritance Tax
- The LDF provides for settlement of all related taxes, late payment interest charges and a favourable 10% penalty rate (20% for tax years post 2008/2009). The penalty for the full disclsoure period is increased to 30% where the assets being disclosed were not declared to HMRC during a previous tax investigation
- The terms of the LDF are complicated. In some cases, the LDF may lead to tracking changes in UK tax, trust and residency laws for the tax years from 1999/2000 to the year of disclosure. There are further regulations (under the LDF) that allow a composite rate of tax of 40% to be applied to the taxable amounts (covering all taxes due), but which would, in turn, involve intensive and time consuming scrutiny of the movement of an individual's funds to ascertain the taxable amounts
- Where it can be demonstrated that reasonable care was taken or that any error or omission of disclosed income and/or gains was entirely innocent, HMRC will not seek to impose penalties

VI . Final opportunity

HMRC has announced that it "will not offer these preferential terms to offshore account holders again"...and "this will be the final opportunity of its kind" (HMRC website).

Taxpayers who do not make use of this final opportunities may face penalties of at least 30% (up to 200%) if HMRC raises its own enquires as a result of future investigations that will ultimately lead to the banks having to reveal the account information.

VII. Aide memoire – LDF vs. UK/Swiss Agreement

As an aide memoire the table below sets out the issues that will need to be resolved and the timescale to be adhered to in order to claim the benefits of the UK/Swiss Agreement and LDF respectively:

UK/Swiss Agreement	LDF
Timing	
Agreement comes into force on 1st January 2013	Five year window to disclose from 1 September 2009 for those with "Relevant Property" and 1 December 2009 for those who have since aquired relevant property
Key features	
• One-off levy of between 21% and 41% (average 25%) of the balance applied to Swiss bank accounts held on 31 December 2010 that remain open on 31 May 2013 • Swiss bank as "paying agent" will levy annual witholding tax on income and gains arising form the relevant asset at: • 48% - Interest Income (excluding interest subject to EU-Savings Tax) • 40% - Dividend Income • 48% - Other Income • 27% - Capital Gains	• Offer of compsite rate of tax (starting at 40%) • Fixed 10% penalty of tax due • Interest also payable on tax due • Immunity from criminal prosecution if full disclosure and no proceeds of crime • Limited period of disclosure, ie from April 1999
Procedure	
• **Option One**: Suffer anonymous annual withholding tax on income and gains of relevant asset(s). This is default position if neither option One nor Two is chosen • **Option Two**: Authorize disclosure of the income and gains arising on relevant asset(s) to Swiss authorities: Result – Swiss authorities will disclose: identity, UK tax reference, name/address of Swiss bank, account number, UK tax year concerned and details of income and gains arising on relevant assets to HMRC • **Option Three**: Make a voluntary disclosure to HMRC under the LDF – (penalties limited to 10% of tax due) • **Option Four**: Make a voluntary disclosure to HMRC other than under the LDF – (potential penalties of 30% to 100% of tax due) • **Option Five**: Move relevant assets to another jurisdiction (High Risk!)	• Establish relevant proerty in Liechtenstein and obtain Certificate of Relevance for registration in the LDF • Bespoke service offered by HMRC • Disclsoure reference and certificate issued within 60 days after initial disclosure to HMRC • Full disclosure report submitted to HMRC including computation of overall tax liability within seven months (if composite rate used) or 10 months in other cases • Election of composite tax rate of 40% (covering all UK taxes incl inheritance tax) • Collating old records and forensic analysis of raw data from bank accounts to determine UK tax figures • Calculation of interest and penalties due
After the submission	
	• Further HMRC correspondence if required • Disclosure Certificate issued by HMRC as guarantee of finality