The International Family Offices Journal

Editor: Barbara R Hauser

September 2017 • www.globelawandbusiness.com

STEP ADVISING FAMILIES ACROSS GENERATIONS

Globe Law and Business

Recent developments affecting the Swiss wealth management sector

Tobias F Rohner, Andrea B Bolliger and Marnin Michaels

For Switzerland as a global wealth management centre, recent years have been characterised by ongoing upheaval. The past several years have seen expanding global trends towards transparency in the financial industry, and this trend has persisted over the past year. The United States has continued to specifically target Swiss banks, but this year also saw some interesting changes on the part of the Swiss government. In response to mounting global pressure, Switzerland has been taking internal measures to promote transparency.

In this article we discuss some of the recent developments that are impacting Switzerland's wealth management sector, including family offices across the nation. With a disproportionate number of family offices based in Switzerland, it is especially important to understand the changes that have occurred, and to be prepared for those on the horizon. These developments include the US-Swiss Non-Prosecution Agreement Program for Swiss banks, the implementation of the Foreign Account Tax Compliance Act (FATCA) and potential changes to the US-Switzerland Intergovernmental Agreement, and Switzerland's participation in certain international exchange of information agreements, including the CRS (Common Reporting Standard). Further, we will discuss Corporate Tax Reform III that was rejected by the Swiss voters early in 2017. However, the rejection does not mean that the discussion is off the table. The discussion on the corporate tax reform must remain vital as the European and international pressure on the Swiss preferential tax regimes has not lessened. It is very likely that the preferential tax regimes will be abolished within the next few years. As one measure (besides many others) to remain attractive and competitive in the international tax environment, numerous cantons have announced plans to further reduce the corporate income tax rates.

Implementation of FATCA and the US-Switzerland Intergovernmental Agreement

On July 1 2014, FATCA came into effect. Financial institutions in Switzerland have therefore begun to implement the requirements put in place by this far-reaching legislation and the related Intergovernmental Agreement (IGA) which was signed by the United States and Switzerland. FATCA imposes many due diligence burdens on Swiss banks with regard to accounts that are identified as US accounts or that refuse to be identified, and these are summarised below. Additionally, Switzerland has recently proposed switching its IGA from a Model 2 to a Model 1 IGA, as discussed in more detail below. This could mean a switch from the potential exchange of certain information on request to the reciprocal automatic exchange of information on an annual basis.

A brief summary of FATCA is helpful to understanding its impact on the Swiss wealth management industry. FATCA was enacted in 2010 by the US Congress to target non-compliance by US taxpayers using foreign accounts. The key provisions of FATCA focus on defeating tax evasion. Congress was concerned about US persons avoiding tax through the use of foreign financial institutions. FATCA essentially enlists these foreign financial institutions (FFIs) to assist the Internal Revenue Service (IRS) in locating and reporting on US persons who have accounts at that institution. FATCA requires the withholding of 30% of any payment to FFIs or certain non-financial foreign entities (NFFEs), unless they identify and document US beneficial owners of accounts and US-source payments. FFIs can enter into an agreement with the IRS to undertake certain identification, documentation and reporting requirements in order to avoid having the withholding apply to payments they receive. Entering into and complying with one of these FFI agreements categorises the institution as a participating FFI (PFFI). FATCA is aimed not at raising revenue, but rather at obtaining information and forcing US persons to report their income by enlisting the aid of institutions outside of the United States.

The US government has negotiated IGAs with other jurisdictions to ease the implementation of FATCA. It has released two types of model IGAs to facilitate this implementation – Model 1 IGAs and Model 2 IGAs. FFIs in a jurisdiction that is treated as having an IGA in effect will be covered by that IGA. In jurisdictions that have a Model 1 IGA with the United States, FFIs will generally not need to enter an FFI agreement in

Various cantons in Switzerland have laws in place under which wealthy individuals intending to reside in Switzerland can negotiate a fixed tax (known as a forfait or lump sum tax), in lieu of paying ordinary income tax each year.

order to avoid being subject to withholding. While they will need to register with the IRS, they will not be required to engage in the withholding or reporting requirements of PFFIs. Instead, the jurisdiction's tax authorities will relay required information to the IRS. In Model 2 jurisdictions, FFIs will still need to enter into an FFI agreement with the IRS and become a PFFI to avoid being withheld upon. However, the terms of the FFI agreement applicable to them will be modified by the terms of the Model 2 IGA in place.

As it does for many jurisdictions, FATCA potentially imposes a large administrative burden and a great deal of complexity on Swiss financial institutions. In order to facilitate the implementation of FATCA and reduce this burden, the United States and Switzerland entered into a Model 2 IGA on February 14 2013 (US-Switzerland IGA). This IGA came into effect on 2 June 2014. The Swiss national legislation implementing FATCA came into effect on June 30 2014.

As discussed above, the Model 2 IGA allows countries with local law impediments to provide information on US accounts held by FFIs. Therefore, rather than providing a mechanism for Swiss FFIs to report to the Swiss tax authorities which then pass the information to the IRS, the US-Switzerland IGA provides for direct reporting from the Swiss FFIs to the IRS. While no reporting deadlines have yet occurred, Swiss FFIs have already begun the process of implementing due diligence requirements under FATCA and collecting relevant information.

On May 21 2014, the Swiss Federal Council adopted a draft negotiation mandate to be discussed by the relevant Swiss parliamentary committees and cantons. One recommendation of the Council was to negotiate a switch from Switzerland's Model 2 IGA with the United States to a Model 1 IGA. The Council indicated that the purpose would be to enable the automatic exchange of information on a reciprocal basis. Under a reciprocal Model 1 IGA, the United States would also be required to turn over to Switzerland the tax information of Swiss residents holding accounts at US financial institutions. This would be a major adjustment from the current Model 2 IGA, which does not allow for the automatic exchange of information between the two governments.

Exchange of Information Agreements

Several years ago, we saw the beginning of a big push by the Organisation for Economic Cooperation and Development (OECD) to encourage countries to agree to tax information exchange agreements (TIEAs). Soon after, the United States and the OECD started promoting automatic and spontaneous information exchanges on a cross-border basis. This effort culminated in the OECD's Common Reporting Standard for the Automatic Exchange of Financial Account Information in Tax Matters (CRS), which will allow participating jurisdictions to exchange tax information with each other in a uniform, standardised way.

Switzerland is now a full participant in the CRS and by 2018 will be exchanging tax information with at least 88 countries, including the entire European Union.

Taxation

Lump sum (forfait) taxation

Various cantons in Switzerland have laws in place under which wealthy individuals intending to reside in Switzerland can negotiate a fixed tax (known as a *forfait* or lump sum tax), in lieu of paying ordinary income tax each year.

Lump sum taxation is seen by many as an important incentive and immigration planning tool for non-Swiss high net worth individuals. However, it has recently been the subject of controversy in Switzerland. Various cantons have begun to change their policies on lump-sum taxation in the last 10 years, and the canton of Zurich was the first canton to abolish the regime in 2009. To date, the cantons of Schaffhausen, Appenzell A.Rh, Basel-Stadt and Basel-Landschaft have abolished the lump-sum taxation as well. At the federal level a bill was proposed that would have required the repeal of lump sum taxation throughout the nation, and a popular vote was held on the proposal on November 30 2014. Although the proposal did not pass (59.6% of the voters rejected it), it exemplified the recent changes in a part of Swiss public opinion towards lump-sum taxation in Switzerland.

Despite or rather because of the failure of the proposal to repeal lump-sum taxation, there are new national requirements on these policies and, furthermore, several cantons have introduced stricter rules (eg, Bern, Glarus, Lucerne, Nidwalden, St Gallen and Thurgau).

To increase the public acceptance of lump-sum taxation, the Federal Government has introduced the following stricter requirements, which have been adopted by a new law:

- the minimum tax base was increased to seven times the annual actual or deemed rent or, alternatively, three times the annual price for board and lodging;
- for federal income tax purposes, the minimum tax base is Sfr 400,000 or seven times the annual actual or deemed rent; the cantons shall define a minimum tax base as well; and
- the cantons are obliged to take into consideration the net wealth tax.

It is fair to say that the new measures are now here to stay. The new measures are effective as from January 1 2016 (federal and cantonal level). Individuals subject to lump-sum taxation on that date benefit from a grandfathering clause of five years (ie, until December 31 2020).

National estate and gift tax

On June 14 2015, the Swiss voters clearly rejected (71% of the voters rejected it) a public initiative to introduce an inheritance and gift tax at the federal level. The proposal, first raised in 2011, had the intention to introduce a uniform inheritance and gift tax on the federal level which would have replaced the current cantonal inheritance and gift tax regimes. The proposal included a flat tax of 20% for transfers of property at death or by gift, with an exemption for the first Sfr 2 million. Transfers among spouses and registered partners would have been exempt, but no exemption would have applied to others, including direct descendants. Since the voters rejected the proposal, the current cantonal regimes remain in force. Nearly all Swiss cantons levy inheritance and gift taxes provided the deceased or donor has been a resident of the respective canton (or Swiss real estate is part of the inheritance of gift). The canton of Schwyz does not levy inheritance and gift tax at all and the canton of Lucerne only levies inheritance, but no gift tax. The applicable gift tax rates vary widely from canton to canton. The tax rate depends on the degree of kinship between the transferees and are progressive in most cantons. Spouses and registered same-sex partners are generally exempt from inheritance and gift tax. Most cantons, with the exemption of Appenzell I.Rh, Neuchatel and Vaud, further exempt transfers to direct descendants (children and grandchildren).

Corporate Tax Reform III

In September 2014, the Swiss government issued a proposal for a comprehensive reform of the Swiss corporate tax system. The purpose of the reform is to both increase international acceptance of the Swiss corporate tax system and to enhance Switzerland's attractiveness for multinational corporations. On February 12 2017, Swiss voters rejected (by 59.1%) the federal bill on Corporate Tax Reform III (CTR III).

Among other measures, CTR III aimed to replace cantonal tax regimes with a new set of internationally accepted measures (eg, patent box, notional interest deduction). Interestingly, the previously discussed capital gains tax for private capital gains – which are currently tax free – and the introduction of an 'exit tax' were not included in the proposed bill adopted by the Federal Parliament last summer. Several cantons already provide very attractive corporate income tax rates in the range between 11.5% and 15% (effective tax rate including federal tax). In the course of the CTR III, numerous cantons were announced to further reduce the corporate income tax rates to strengthen their fiscal attractiveness and competitiveness in an international environment.

The commitment to and the need for a corporate tax reform remains undisputed and the Federal Council announced that it will prepare a revised bill on the CTR III. First proposals are expected in mid-2017. Timing is currently unclear. It is expected that the revised CTR III will not take effect in 2019 as planned, but may be delayed by up to three years. Currently it is unclear which measures will be included in the revised CTR III. It is expected that the abolishment of the preferential cantonal tax regimes – like the Swiss holding company, Swiss mixed company and Swiss administrative company – will be retained. However, these regimes remain available until the revised CTR III will be enacted.

Lump sum taxation is seen by many as an important incentive and immigration planning tool for non-Swiss high net worth individuals.

White-money strategy

A white-money strategy, or white-money policy, is an approach taken by various institutions and countries to address the use of such institutions or jurisdictions by non-residents as a means of circumventing their home country tax laws. In essence, white-money strategies compel financial institutions to obtain a declaration from clients that the funds at issue are properly taxed in the clients' jurisdictions of residence. Historically, such policies have only been needed in jurisdictions in which the evasion of foreign taxes is not a crime.

In jurisdictions in which foreign tax evasion is a crime under anti-money laundering rules, there is no need for a separate white-money policy because the existing anti-money laundering rules serve the same function. For example, within the European Union, the Third Anti-Money Laundering Directive (the Directive), effective in July 2006, made foreign tax evasion a money laundering predicate offence. Thus there is no need to implement a separate, formal white-money strategy in the European Union.

However, in jurisdictions that do not have separate anti-money laundering rules that criminalise foreign tax evasion, white-money strategies are necessary to ensure that local financial institutions are not being used to hide undeclared funds. As a result of the global trend, beginning in 2008, towards increased attention on international tax evasion and the change in attitude towards the issue of transparency and undeclared funds, many jurisdictions and financial institutions have decided that they would attempt to ensure that at least new funds, and possibly preexisting funds, would be accepted only from declared sources. Switzerland is one of these jurisdictions and has been exploring the possibility of implementing a white-money policy on the federal level since 2010. Below we discuss the developments regarding this policy in recent years.

In 2012, the Swiss government, specifically the Federal Council, began exploring a strategy for a tax-compliant and competitive financial centre. Part of this strategy aimed to prevent the acceptance of untaxed assets by requiring enhanced due diligence requirements, sometimes referred to as the 'Financial Integrity Strategy', essentially a white-money strategy. This was in part motivated by Switzerland's acceptance of the 2012 revised Financial Action Task Force (FATF) recommendations, which in part require jurisdictions to implement measures to identify the beneficial owners of legal entities and enhance transparency. The Federal Council also instructed the Federal Department of Finance (FDF) to submit a corresponding consultation draft by the beginning of 2013. Towards the end of 2012, a report on Switzerland's financial market policy was issued by the Federal Council. The report contained a section on the Financial Integrity Strategy, which included new due diligence requirements for financial intermediaries, and how it would be implemented.

As a result of the above summarised discussions, Article 305bis of the Swiss Criminal Code was altered with effect as of January 1 2016. This provision states that a qualified tax offence is considered to be a predicate offence to money laundering, whereby a qualified tax offence means a qualified tax fraud in the area of direct taxation (ie, forgery of documents) provided that the evaded taxes exceed the amount of Sfr 300,000 per tax year. The altered provision has been criticised by numerous commentators because it leaves room for various interpretations. In particular, it is unclear how the tax amount of Sfr 300,000 has to be computed. Taking a conservative approach, many Swiss banks are requesting from actual and prospective customers a written confirmation by an unrelated party (eg, a tax adviser) confirming the tax compliancy of the customer.

Conclusion

There has been a big push globally for more transparency in the financial industry, and in wealth management in particular. Recent years have shown a consolidation and competitive dynamics in the Swiss banking and wealth management industry. However, the fact that numerous banks are reporting continued net new money inflows reflects that the Swiss banking and wealth management industry has successfully implemented its white-money strategy and is stronger than ever before.

Dr Tobias F Rohner is a tax partner at Baker McKenzie's Zurich office. Tobias has broad experience in corporate and individual tax matters. He focuses his practice on corporate tax planning for Swiss and multinational companies, cross-border business restructuring, real estate transactions and VAT. He advises on all tax aspects of reorganisations and M&A transactions as well as equity compensation programmes. He also assists private clients in wealth planning and voluntary disclosures, and represents them in tax audits and litigation. Tobias is a lecturer in tax law at Zurich University and Zurich University of Applied Sciences, and is a frequent speaker at national and international conferences. He also regularly writes academic articles on taxation. Tobias graduated from the University of St Gallen and Lausanne and is admitted to the bar in Zurich. He is a certified tax expert and holds a PhD in law.

Andrea B Bolliger is a member of Baker McKenzie's Tax and Global Wealth Management practice groups in

Zurich/Switzerland. Andrea graduated from the University of St Gallen (HSG School of Law) in 1998 and was admitted to the bar in 2000. He earned an LLM in American Law from Boston University in 2001. In 2004, he became a Certified Swiss Tax Expert. Since 2001 he has worked for leading international law firms in Zurich as well as for the tax authorities of the Canton Zurich. Andrea has over 10 years' experience in all tax matters, both individual and corporate tax. His practice focuses in particular on advising private clients in complex national and international tax planning, including relocation, estate planning, and all aspects of wealth management. Further, he has broad experience in national and international corporate tax matters, including restructurings, M&A, corporate finance, tax planning and structuring as well as tax controversy.

Marnin Michaels, a senior partner at Baker McKenzie Zurich, has been practising in the areas of tax and international private banking for approximately 20 years. He handles insurance matters relating to tax investigations and wealth management, as well as counselling clients on issues relating to US withholding tax, qualified intermediary rules and FATCA.

'Recent developments affecting the Swiss wealth management sector' by Tobias F Rohner, Andrea B Bolliger and Marnin Michaels is taken from the fifth issue of the new *The International Family Offices Journal*, published by Globe Law and Business, http://ifoj16.globelawandbusiness.com.