Tax Transparency and the Automatic Exchange of Information

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- **In Switzerland, the automatic exchange of information will become effective as per 1 January 2018**
- **The AIA is a systematic and periodic transmission of taxpayer information**
- **Financial market participants will have to conduct a planning and need analysis**

1. Introduction

On 1 January 2017, the Federal Act on International Automatic Exchange of Information on Tax Matters ("AIAG") will enter into force and will require all financial market participants to conduct a planning and need analysis.

The AIAG is the Swiss implementation act to the OECD Convention on Mutual Administrative Assistance in Tax Matters (Amtshilfeübereinkommen), a multinational convention ratified by Switzerland in 2013 and whose consultation period expired on 21 April 2016.

AIAG and OECD Convention are the legal basis of a new approach in tax matters, namely the so-called "automatic exchange of information" (Automatischer Informationsaustausch / "AIA"). The AIA shall provide for the systematic and periodic transmission of taxpayer information from the country in which the financial account is located to the taxpayer's country of residence/domicile. The information to be exchanged will cover all types of investment income.

The AIA is the logical outcome of a globally intensified battle against tax evasion, a development having started shortly after the financial and economic crisis in 2008.

In Switzerland, the automatic exchange of information will become a reality as per 1 January 2018. The collection of the respective data will start one year earlier, as of 1 January 2017.

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2. Implementation of the AIA

The AIA applies amongst countries having concluded a bilateral agreement implementing the AIA (like the "Protocol of Amendment to the Agreement on the Taxation of Savings Income" dated 27 May 2015 between Switzerland and the EU) or by means of the OECD Convention, its additional Multilateral Competent Authority Agreement ("MCAA") and a bilateral activation of the AIA (like the joint declaration between Switzerland and Australia dated 3 March 2015).

Both bilateral agreement and bilateral activation have to be approved by the Federal Assembly. The bilateral agreement with the EU and the bilateral activation with Australia have already been approved by the Federal Assembly and will enter into force as of 1 January 2017, with a data exchange starting on 1 January 2018. Further joint declarations with Guernsey, Isle of Man, Iceland, Japan, Jersey Canada, Norway and South Korea have been ratified and are also expected to enter into force by 1 January 2017.

In the following sections, the attempt has been made to give a short but comprehensive overview of the key elements of the AIA.

3. Persons and Legal Entities subject to the AIA

In Switzerland, financial account information of natural persons or legal entities with a Swiss bank account will be transmitted to the tax authorities of their country of residence/domicile – provided that such state is an AIA contracting state.

Inversely, financial account information regarding foreign accounts of Swiss taxpayers will be transmitted by the country in which the financial account is located to the Swiss tax authorities – provided that such state is an AIA contracting state.

Under the AIA, the term legal entities encompasses all types of entities irrespective of their legal form, like associations, condominium owners' associations, foundations and trusts that do not qualify as reporting financial institutions as defined under section 4 below.

4. Reporting Financial Institutions

Under the AIA, not only banks and custodial institutions but also brokers, specified insurance companies, trusts and undertakings for collective investment ("UCIs") can qualify as Reporting Financial Institutions.

The term Reporting Financial Institution is defined as "any financial institute in a contracting state which is not a Non-Reporting Financial Institution".

According to the AIAG, Non-Reporting Financial Institutions are the following:

- The Swiss Confederation, Cantons, Communities and their fully owned institutions;
- International organisations and diplomatic missions;
- The Swiss National Bank;

- Pension funds;
- Specified credit card providers;
- Specified collective investment schemes;
- Condominium owners' associations and specified joint-owners' associations;
- Central securities depository according to the Financial Market Infrastructure Act;
- Specified asset managers;
- Trusts with a financial institution as trustee which fulfills the reporting duties on behalf of the trust.

Reporting Financial Institutions are subject to various duties under the AIA which are outlined under section 6.

5. Reportable Financial Information and Accounts

The Reportable Financial Information concerns all types of investment income (such as dividends, interests, from certain insurance contracts and other similar income) as well as account balances and proceeds from the sale of financial assets.

Consequently, the Reportable Financial Accounts include all types of accounts like depository accounts, custody accounts, surrenderable insurance contracts, annuity insurance contracts, equity interests as well as debt interests in an investment entity (loans and credits, shares and capital contributions, dividends and revenues).

Excluded from the definition of Reportable Financial Accounts are retirement saving accounts (professional pension and tied third pillar pension), rental deposit accounts, capital contribution accounts and accounts of decedents.

With respect to Reportable Financial Accounts, the following information has to be disclosed under the AIA:

- Name, address, date and place of birth, tax identification number of the reportable person/legal entity, and, as the case may be, of the controlling person;
- Account number;
- Account balance, including interests, dividends and other income;
- Name and identification number of the reporting financial institution.

6. Duties of Reporting Financial Institutions

For Reporting Financial Institutions, the following duties arise under the AIA:

a. Registration Duty

All Swiss Reporting Financial Institutions have to register with the Federal Tax Authority.

b. Identification Duty

As of 1 January 2017, Reporting Financial Institutions will have to identify Reportable Financial Accounts and collect information in an effort to identify an account holder's country of residence/domicile.

In order to assess these accounts, the Reporting Financial Institutions are subject to extensive July 2016 (v01) Page 3 Swiss Financial Market Regulation www.pestalozzilaw.com/regulatory documentation requirements and duties of care which are imposed under the AIA.

The due diligence requirements distinguish between pre-existing and new accounts as well as between individual accounts and accounts of legal entities.

i) Pre-existing Individual Accounts

For pre-existing lower-value accounts (account balances of up to CHF 1'000'000), if a Reporting Financial Institution holds a current residence address of an account holder, it may treat that address as the tax residence of the account holder. If no such address is held, a search of electronic records for one of six defined indicia (e.g. telephone number or "hold mail" instructions in an AIA contracting state) has to be conducted. Pre-existing high-value accounts are subject to an additional paper records search for these indicia and a relationship manager enquiry.

If one indicia is found, the Reporting Financial Institution has to treat the account holder as a taxpayer of that identified jurisdiction unless such residency status can be rebutted by documentary evidence.

ii) New Individual Accounts

With respect to new individual accounts, the Reporting Financial Institution has to request a self-declaration from the account holder in order to determine the tax residence of the individual. The reasonableness of such self-declaration has to be confirmed by the information obtained in connection with the opening of the account, including any documentation collected according to anti-money-laundering/know-your-customer procedures.

If the Reporting Financial Institution cannot obtain the relevant information regarding name, address, date of birth of the account holder or the controlling person within 90 days, the account has to be closed.

iii) Pre-existing Legal Entitiy Accounts

As concerns pre-existing legal entity accounts, a threshold of CHF 250'000 applies, below which no reporting is required. However, if the pre-existing legal entity account is held by a non-financial entity ("NFE") (i.e. a legal entity that is not a financial institution), the Reporting Financial Institution will have to determine whether the legal entity is active (e.g. a NFE whose shares are regularly traded on a stock exchange or a NFE with less than 50% of its gross earnings deriving from passive income and less than 50% of its assets generating passive income) or passive. If the legal entity qualifies as a passive NFE, the controlling persons as well as their residency have to be identified.

In the event that any controlling person of he NFE is a resident of another jurisdiction, the account has to be treated as an account of that jurisdiction.

iv) New Legal Entity Accounts

With respect to new legal entity accounts, the Reporting Financial Institution has to determine the legal entity's status and has to ask for a self-certification of the entity's domicile. Once obtained, the Reporting Financial Institution may treat the account holder as a financial institution or active NFE if the account holder is generally known as such. In all other cases, the account holder must provide for a self-certification of its classification.

As far as the legal entities qualify as financial institutions, they have to fulfill the respective reporting obligation by themselves.

c. Information Duty towards the Reportable Person/Legal Entity

At the latest by 31 January of the year in which Reportable Financial Information is transmitted, the affected reportable person/legal entity has to be informed by the Reporting Financial Institution. The information provided will concern the use and exchange of the Reportable Financial Information as well as the rights of the reportable person/legal entity.

These rights include a right to information against the Reporting Financial Institution and the Federal Tax Authority with respect to the Reportable Financial Information, its origin and purpose of its processing. The reportable person/legal entity only has a right to rectification towards the Reporting Financial Institution, whereas it is limited to transmission errors towards the Federal Tax Authority. The reportable person/legal entity has no right against the Federal Tax Administration to have the Reportable Financial Information blocked.

d. Reporting Duty to the Federal Tax Authority

The Reportable Financial Information shall be transmitted to the Swiss Federal Tax Authority within six months of the end of the relevant calendar year. The Federal Tax Authority will then transfer it to the tax authorities of the country of residence/domicile of the account holder.

e. Further Duties

In addition to the above mentioned duties, the Reporting Financial Institutions will also need to prepare for the handling of incoming enquiries. This means that July 2016 (v01) Page 4 Swiss Financial Market Regulation www.pestalozzilaw.com/regulatory they have to be cautious with respect to transfer and cash withdrawal requests of non-Swiss residents in case that such

transactions appear to be high-risk transactions from an anti-money-laundering/tax evasion perspective.

7. Taxes subject to the AIA and Confidentiality

The scope of application of the OECD Convention covers a wide range of taxes. However, the contracting states are entitled to make reservations. In such event, the extent of use of the Reportable Financial Information is reduced accordingly. Switzerland has taken this opportunity and limited the scope of application to income, wealth, profit, capital and withholding taxes. Thus, neither Switzerland nor its AIA contracting states may use the received Reportable Financial Information for the assessing and collecting of inheritance and gift tax, VAT, issue and sales tax and any social security contributions.

The Federal Tax Authority as well as non-Swiss tax authorities are subject to the same confidentiality and data protection requirements as for data received under domestic law. Thus, and in accordance with the speciality principle, the Reportable Financial Information shall only be transmitted and disclosed to state authorities in charge of the assessing, collecting, enforcing and prosecuting of taxes falling under the AIA.. Exceptions may apply in cases of money laundering, corruption and terrorist funding.

8. Implications of the AIA on the Banking Secrecy

a. On an International Level

With the introduction of the AIA, Switzerland will receive unrequested bank account related information from other AIA contracting states. Swiss authorities will be entitled to use this information and it is expected that Swiss authorities will make use of such possibility.

Inversely, bank account related information of foreign taxpayers having a Swiss bank account will be reported to the country of residence/domicile provided that such country is an AIA contracting state.

b. On a National Level

The national banking secrecy regarding financial information on Swiss bank accounts of taxpayers in Switzerland will not be affected by the AIA.

9. AIA and FATCA

The US Foreign Account Tax Compliance Act ("FATCA") and AIA follow two separate streams. Under FATCA, Swiss financial institutions directly report the requested information to the US tax authorities whereas under the AIA such reporting is made towards the Swiss Federal Tax Authority. Furthermore, FATCA only provides for a transmission of data to the US – Switzerland does not receive any data from the US. As of the date of this Newsletter, the US are not a contracting AIA state. Consequently, the regime under FATCA will continue to be applied between Switzerland and the US.

10. Recommendations to Taxpayers in Switzerland

Taxpayers in Switzerland with non-declared assets in an AIA contracting state will face inquiries from Reporting Financial Institutions and transmission of their financial account information to Switzerland. Thus, it is highly recommended that they assess their tax situation and declare these assets in order to ensure the option of a non-punishable voluntary disclosure.

11. Recommendations to Taxpayers in an AIA Contracting State

Taxpayers in an AIA contracting state having a Swiss bank account will receive enquiries from Swiss Reporting Financial Institutions. It is highly recommended that they start assessing their tax situation before their bank information will be transmitted to their country of residence/domicile from 1 January 2018 onwards.

12. Recommendations to Financial Institutions

Reporting Financial Institutions will be subject to a vast range of duties entailing considerable effort. At the latest by 30 June 2018, they will have to make their first reporting to the Federal Tax Authority. It is therefore recommended to start preparing for this upcoming challenge and to find mechanisms to best protect the legal rights of their clients.

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