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Swiss Bank Secrecy: Back to Basics - Measures to be taken by Clients

Now that Switzerland has decided to grant administrative assistance to foreign tax authorities in cases of tax fraud according to the criteria of the requesting state[1], provided the request is targeted at a specific taxpayer and not a fishing expedition, the question arises as to a) when this larger exchange of information will start, and b) what information will be sent from Switzerland to the requesting states. This is important to determine what can be done to limit the risks for clients of Swiss Banks resulting from the new Swiss policy with respect to the exchange of information in tax matters.

a) The Swiss government has indicated that the new rules should apply in a fair way, meaning that the foreign states should not be allowed to take advantage of the Swiss change of practice. Clients of Swiss banks should be protected in their good faith reliance on the Swiss practice of not giving any information in case of tax avoidance but only in cases of tax fraud. This could mean several things, for instance that the foreign states may grant a pardon for past offenses in relation to past tax avoidance, or more likely that the revised exchange of information rules may apply without retroactive effect, i.e. they would not cover information related to tax issues older than the entering into force of the revised treaties. Therefore nothing will change for the clients of Swiss banks as long as the tax treaties have not been renegotiated by Switzerland, but this renegotiation will take place in the near future. Once the amended text of the revised tax treaties have been approved by the governments of the contracting states, the treaties will have to be ratified by the parliaments. This will not happen overnight, even if the text to be adopted is basically the wording in the OECD model treaty with few limitations. One such limitation has already been mentioned by the Swiss government: it has clearly indicated that Switzerland will not provide information in relation to taxes which are not covered by the treaty, despite the fact that the OECD model text states the contrary[2].

b) Switzerland will have to obtain and to provide information accessible to the Swiss authorities, even if the Swiss tax authorities do not need it for Swiss tax

[1] http://www.stswiss.com/shared/publications/Swiss%20Banking%20Secrecy%20reasons%20to%20worry%20and%20if%20yes%20what%20can%20be%20done.pdf
[2] http://www.oecd.org/document/53/0,2340,en_2649_33747_33614197_1_1_1_1,00.html

assessment purposes. If the information is available in Switzerland, then the Swiss authorities will have to get it and forward it to the foreign tax authorities upon specific request. This excludes any automatic exchange of information as practiced for instance within the EU.

The information will have to be provided even if it is held by a bank, a nominee or a person acting in an agency or a fiduciary capacity, but lawyers' secrecy remains fully protected provided the lawyer has acted only as an advisor, legal advice being considered to include tax matters, but not as a financial intermediary.

The due diligence rules applicable in Switzerland in the context of the anti-money laundering legislation represent the main threat to Swiss bank secrecy, and at the same time the main source of potentially interesting information for foreign tax authorities, because every bank and financial intermediary in Switzerland has staff whose primary function is to gather as much information on clients and beneficial owners of assets held in Swiss banks as possible to document the "know your customer rules" and in this way to meet the strict requirements set by the Swiss regulatory authorities. Compliance officers in the Swiss financial institutions are audited at regular intervals to make sure that they have information making it possible to link the funds held in Swiss banks to individuals and that such information is regularly updated, classified and stored. These compliance activities are however never checked to ensure that only correct information is kept, nor are they audited to make sure that no more information is kept than what is necessary to meet the due diligence requirements. This is where action is needed on the part of the clients of Swiss banks[3]. The clients should check, with the help of their legal advisors, that the banks' files do not contain information that is false or not absolutely necessary, and they should also try to ensure that such information is not stored in a way that is too easily accessible to all bank employees.

The Swiss authorities monitoring the anti-money laundering provisions must also restrict the amount of information which they request the banks and other financial intermediaries to obtain from their clients. This is necessary in order not to create unnecessary risks for the clients of Swiss banks given the broader access to such information granted to foreign authorities beyond the initial anti-money laundering scope of these "Due Diligence" measures. The new Agreement between Germany and the Isle of Man signed on March 2, 2009 provides, for instance, only for disclosure of information related to ownership of companies, and ownership chains, and information on the legal settlors (but not on those actually providing the funds), trustees and beneficiaries, but not on protectors (art. 4b iii and iv), nor on the persons who have caused the settlor to

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[3] Due Diligence Bank Records contain sensitive data collections within the definition of the Federal Law on Data Protection of June 19, 1992, as amended. Access to such data must be given upon request to the person whose data is being collected. http://www.admin.ch/ch/f/rs/2/235.1.fr.pdf

The information given must include the origin of the information collected and must give the opportunity to the targeted person to correct the information held in the records.
http://www.edoeb.admin.ch/themen/00794/00819/01086/index.html?lang=fr&downlo

settle the trust[4]. For "Due Diligence" purposes Swiss banks must gather information on the beneficial owners of companies and on beneficiaries of trusts and foundations and on the origin of the assets (inheritance, business income, etc.). If revocable, the name of the person entitled to revoke a trust or a foundation is registered as the beneficial owner of a trust. If the trust or the foundation is an irrevocable discretionary trust or foundation, the bank must have information on the "actual" founders or settlors and not only on those acting in a fiduciary capacity or as nominees (CDB08 art. 4. 43). The "Due Diligence" file must also include information on the names of the persons empowered to issue instructions to the banks' contracting party (the banks' clients) or on its corporate bodies, as well as on the names of the potential beneficiaries, such as classes of beneficiaries, and even on the name of the curators or protectors, if they have the power to oblige the trustees or the board members of a foundation to dispose of the assets or to change the beneficiaries (CDB 08, Form T, point 4)[5]. Normally protectors or key raters should however not have the power to oblige the trustees to disburse funds.

The "Due Diligence" records are from which the real threat of disclosure of harmful private information originates, because these records exist and can therefore be obtained easily by the Swiss authorities granting administrative assistance to foreign tax authorities. Therefore, there is a need for the Swiss banks and their regulators (Swiss Bankers Association and FINMA) to revisit what information they require the banks to keep and how they keep it and the banks must adapt their procedures so as to avoid keeping more information than requested by the law and its implementing rules and regulations, including the Due Diligence for Banks as last codified in 2008 (CDB 08).

For instance, Swiss banks should not keep the names of protectors in their records, if the protectors cannot order the trustees to dispose of the trust assets in favor of specific beneficiaries but can only approve or refuse a decision of the trustees in this respect. This may mean fighting the well established routine at some banks where they do not make any distinction based on the effective powers of the protectors.

Swiss banks must have electronic lists of authorized signatories. They should however not also be forced to input into their electronic databases information about beneficial owners, if these beneficial owners have no legal right in connection with the banking relationship. This information should be kept only in the physical client data file, in case a specific account were to be investigated because of transactions that were carried out through it or because the legal entity or one of its signatories was involved in an investigation. Only if the account must be investigated because the bank's client or its signatories are involved in an administrative or criminal investigation, should the name of the beneficial owner become "disclosable and accessible information". Not registering the beneficial owners in randomly accessible databases would make that information unavailable in the event of an administrative request for assistance in tax matters targeted at the beneficial owner rather than at the company or at the signatories on the account. But of course it would also make

[4] http://www.oecd.org/dataoecd/57/5/42262036.pdf
[5] http://www.swissbanking.org/en/801908_e.pdf

it impossible to retrieve a link between assets held on such an account and deceased persons, which link is presently used to assist heirs in search of assets possibly held at Swiss banks. It is however normally not the banks' duty to inform heirs of the fact that a deceased individual was a beneficial owner of some assets at a bank, but rather it is the obligation of the trustees or directors of the structure holding the assets to let heirs know of the existence of assets to which they are legally entitled.

Accordingly, clients of Swiss banks should take measures now to protect their privacy for the future, keeping in mind that the risks arise from two main sources: international assistance including in tax matters, and illegal breach of secrecy.This latter remains exceptional, even if we have seen in the recent past that foreign authorities are willing to pay large sums of money to get unauthorized access to confidential client data in some jurisdictions. While Swiss bank secrecy still provides for criminal sanctions against unauthorized disclosures of information, such sanctions are no real compensation for the damage caused by such disclosures.

Numbered or coded Swiss bank accounts are still a means to obtain increased protection against breaches of confidentiality. What this means in practice is that the name of the account holder is not available to the bank's employees in the main computer system, but only in a separate room or system, accessible by a few staff members only. Since this service complicates the bank's internal procedures, this service is normally only available in return for a special fee. Recent developments have not made numbered accounts obsolete, quite to the contrary. But they are no protection against dissemination of confidential information by the clients themselves (the most frequent source of problems), nor against legitimate requests for information by foreign authorities.

Offshore companies, used particularly in conjunction with trusts or foundations, are and will continue to be an efficient tool against invasion of privacy via investigations by tax authorities, provided they are used in a legitimate way. What this means is that no interference by the individual whose assets are transferred into such structures should take place, once the transfer of assets to such structures has occurred[6]. Limited powers to provide guidance as to how to invest the assets or conduct the business of such structures, or even a limited management power to manage the portfolio of such structures, is possible, as long as such power does not include any right to withdraw or disburse the assets.

Furthermore, the trustees of a trust or members of the board of a foundation must not be required to follow instructions by way of a mandate from a third party, as is presently often the case, as this could defeat the very purpose in setting up such structures.

Whenever specific beneficiaries can be identified within legal structures holding bank accounts (for instance specific heirs), the risk of the banks collecting information about settlors or founders is reduced, because they have no legal obligation to do so in such

[6] The consequences of retaining effective control over assets nominally transferred into an account in the name of offshore entities are discussed in the following article: http://www.stswiss.com/shared/publications/Swiss%20Bank%20Secrecy%20US%20based%20clients%20are%20in%20trouble.pdf

a case except to document the legitimate origin of the assets. If on the other hand the foundations or trusts are irrevocable and discretionary, the banks are likely to gather more information regarding the origin of the assets and their future use than when they have a named and clearly identified individual as beneficiary. In cases where there is no pre-identified individual beneficiary, it is particularly important to confirm that this information is kept by the bank in a format that makes it unretrievable in the context of fishing expeditions, i.e. separate from the account holding structure which is the bank's legal client, and separate from the account's activity.

The precise account holding structure to be used depends primarily on the client's individual needs and circumstances. But the above general principles may assist clients of Swiss banks in taking appropriate measures and in adjusting to the new rules, and therefore should always be kept in mind. This guidance, together with a review of what information the banks or other financial intermediaries keep in their files and how it is kept, are essential tools to avoid future risks of involuntary forced disclosure of confidential information.

Eric W. Fiechter / 26.03.2009