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New Double Tax Treaties Switzerland – Germany / United Kingdom: Potential impact on banking business

Background

In August 2011 the double tax treaties between Switzerland and Germany, Great Britain and Northern Ireland („UK“) were ratified. These agreements aim at enforcing the effective taxation of the income from assets of German and British investors managed in Switzerland. The primary goal of these two treaties is the identical taxation of the investment income no matter whether the client’s assets are managed in Germany / UK or in Switzerland.
The full text of the treaties shall be published after the signature of the respective governments. The double tax treaties (“DTTs”) will then go through the necessary legislative steps in the concerned countries.
Both treaties will become effective from 2013. This newsletter outlines the most important aspects of the treaty and its implications on banks operating in Switzerland serving German and/or UK clients (Source: “Rohstoff” from Eidgenössisches Finanzdepartment).

Compensating Taxation of the Past

Both DTTs introduce the application of a flat tax on investment income while assuring the non-disclosure of the investors. The taxable basis will be formed by the capital at certain cutoff-date(s) while the applicable withholding tax rate is a function of the duration of the individual client’s relationship with the bank; these individual rates will range from 19% to 34%. This one-off charge will not apply if the client authorizes the bank to fully disclose his relationship with the bank to the corresponding tax authorities.
Each individual client may assess – with the support of his bank – which of the two alternatives is more efficient given his individual situation. This assessment involves the retroactive computation of the client’s tax burden; the client may therefore refer to his bank for supporting information such as retroactive tax reports. We therefore assume an increasing demand for such reports.
If neither of the two alternatives is accepted by the client, the bank has to close the client relationship i.e. the client’s accounts and depots.
The DTT with Germany foresees a distribution of such collected taxes between the entitled public bodies in Germany, i.e. the “Bund” and the “Bundesländer”.

Taxation of Future Capital Income

The bespoken DTTs introduce a “flat taxation” for clients fiscally resident in Germany or UK referring to the country specific taxation of investment income according in these countries:

- For German clients analogous to the German final levy taxation: 25% capital income tax plus 5.5% solidarity surcharge and – upon client’s election – a church tax (8% or 9% depending on the “Bundesland”)
- For UK clients analogous to the British income tax: different rates – derived from the marginal income tax rates – apply depending on the income type (48% on interest and other income, 40% on dividends and 27% of capital gains)

Furthermore, the client can opt for a full disclosure in which case no withholding tax shall be applied in Switzerland. In return the client will ask for an accurate reporting in order to properly declare his investment income in his home country.
Other tax regulations (EU savings directive, Swiss withholding tax) are not affected by these bilateral agreements.
The accurate tax computation and/or tax reporting for clients from Germany / UK imply the consideration of the local tax usances of Germany and UK such as:

- Determination of the tax base under consideration of country specific data enrichment („WM-data“)
- Consideration of relevant tax exemptions (e.g. “loss pots”)
- Offsetting of foreign source taxes by usage of DTTs between home country of client and third country
- Observance of country specifics (FX-rates to be used, consumption sequence in case of sales, treatment of corporate actions etc.)

Potential Impact
The Swiss banking industry faces different challenges:

- From past experiences, banks can estimate the efforts for providing the client with the necessary information for the self-disclosure
- Elicitation of additional client static data (e.g. „tax status", religion, federal state)
- Country specific data sourcing from additional data providers
- Adjustments of the accounting and settlement systems in order to determine and register the (country specific) flat tax
- Provision of country specific client and authority reports

The development and maintenance costs for the IT adjustments and bank processes will significantly increase with any additional comparable treaty.
The involved efforts are primarily driven by the applicable quality standards in line with the standards in the home country of the client for both the tax computation and the reporting.

Strategic Challenges
In return, Swiss banks are granted an easier market access in Germany and UK plus any potential issue in relation to past tax evasion is deemed to be resolved. This leads to a higher competition among banks from the home country of the clients and the Swiss banks. Therefore, the consideration of fiscal aspects in the client relationship will become a business-critical success factor: relevant tax information has to be made available whenever required in the client advisory and reporting processes as well as upon the execution of client orders or corporate actions.
Facing these challenges, executives may be urged to take business decisions like focusing on a limited number of core markets.

Timeline
The implementation of the new tax requirements is time-consuming and costly. We therefore recommend an early start with the transformation since these complex requirements must be in place by 2013. Relevant experiences in the area of tax requirements and their implementation in the banking industry are mission-critical success factors for a timely implementation. As specialized consultancy company focusing on fiscal compliance in the banking industry for more than 10 years, Banking Concepts can effectively assist its clients coming to terms with such complex initiatives and hence provide an added value.

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