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New Double Tax Treaty Switzerland – Germany: Possible effects on banking business with German clients

Background

On October 27th 2010 the new Double Tax Treaty (DTT) between Switzerland and Germany, including the exchange of information according to OECD standard, was signed. Furthermore it was agreed to negotiate on further open tax issues between the two countries. It is expected that these new regulations will significantly impact banking business with German clients.

Relevant core issues of the DTT and forthcoming further negotiations

The main topics of the new regulations are:

- Taxation of non-declared German assets in Switzerland
- Taxation of current income in Switzerland as well as donations and heritages (capital transfer taxes)
- Extended market access for Swiss domiciled banks in Germany
- Handling of stolen bank data

Current state of knowledge

According to the press a flat rate of return (app. 3% per annum) is to be applied on non-declared assets for the past. To this assessment basis, and to current returns, a flat rate withholding tax rate of app. 35% is expected to be applied.
The details of the calculation formulas and assessment basis are subject to negotiations. If and how withholding tax paid in Switzerland anonymously will be considered in the tax assessment in Germany has yet to be answered. The date on which the new regulations will come into effect depends on the ratification of the treaty in both countries. It is likely that this will happen on 1.1.2012, even though in principle any earlier or later date is still possible.

Potential impact on Wealth Management

Based on the currently available information it has to be expected that Wealth Management for German clients will be impacted in different areas:

- For non declared assets verification is recommended in order to decide whether a voluntary declaration of tax liabilities is more appropriate than applying the rules as envisaged in the new regulations. This verification should be done in every single case and implies proper assessment of historic income and capital gains according to (historic) German tax laws.
- If the future withholding tax rate in Switzerland would be higher than the onshore tax rate in Germany this would put the investor at a disadvantage. The tax rate in Germany is currently max. 27.99% taking into account both solidarity charge and church tax and demands a complex calculation of the appropriate assessment basis.

Further possible effects that cannot be judged yet:

- In order to allow the German investor to reclaim from the German tax authorities the taxes paid in Switzerland that exceed the “onshore tax rate” it is necessary to provide the investor with a full and accurate tax reporting following German regulations. Even in this case the investor would have a liquidity disadvantage, since financial institutions domiciled in Germany can reclaim overpaid taxes any time during the year.
- Of interest is furthermore the question to what extent the calculation logic as defined during the negotiations has to be applied, or if it will be possible to apply the more complex German onshore tax rules. This issue might be relevant also from the perspective of simplified German market access for Swiss domiciled financial institutions. In some core banking systems German onshore tax rules are modeled already today, which would entail less development efforts.

Strategic challenges

Possible effects on Wealth Management draw attention to a number of strategic issues in managing foreign clients. It is likely that besides the United Kingdom and Germany also other European countries will be interested in similar treaties with Switzerland.

Due to several new regulations it is to be expected that tax related issues will gain even more importance for banking business. Modifications in other jurisdictions (EUSD, FATCA) have to be taken into account as well.

The finance industry expects that the necessary adjustments demand considerable investment efforts.

Challenges on operational level

The accounting systems must be enhanced and changed so that they are able to handle the new regulations, since these represent applicable national law. In order to allow a deduction of paid taxes during tax assessment and to avoid a disadvantage for assets held abroad, German practices for client reporting (capital income and gain report) remain imperative. For investment advice and investment decisions of these clients tax amounts should be used that are calculated according to onshore rules and not only according to Swiss withholding tax regulations, since the latter would not necessarily represent the final tax burden of the client.

The entire process chain has to be analyzed:

1. The data supply from Wertpapiermitteilungen (WM-Daten): this data provider is recognized by the German Tax Authorities as far as no indication of erroneous data is given. Therefore data should be checked on plausibility and prepared according to the requirements of the system where the data will be processed.
2. Accounting systems: tax calculation, booking and legal reporting according to the new regulations must be available.
3. Client advice and client reporting: these will possibly continue to seek realignment with the German onshore practices.

Time-scale

Our experience with the introduction of new tax regulations shows that their implementation requires considerable preparation work. Therefore we recommend to every financial institution to clarify the basic strategic issues, in order to be able to start implementing the new rules in 2011. Among the issues that must be clarified are a.o.: client analysis, assessment of IT systems and defining courses of action.

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