

Tax treaty between Switzerland and Germany: Latest developments

Background

Regarding the Swiss - German tax treaty ratified in August 2011 the Swiss tax administration has now issued a first draft of the respective tax guidelines. Furthermore, on 20.03.2012 changes on the respective tax treaty between Switzerland and the United Kingdom have been made, especially on the treatment of inheritances, which might result in a respective amendment of the tax treaty with Germany as well.

Final levy taxation for future capital income („AGS“)

The drafted guidelines do now include more detailed statements on the tax deduction obligations for the bank in case of foreign fund accumulations. The bank shall deduct the resulting tax on all foreign fund accumulations in a deferred and combined way on April 30th of the following calendar year. If the fund units have been disposed in the meantime, no deduction will be required, since the accumulated income has already been tax-wise considered within the AGS deduction on the capital gain. However, the following points must be considered in this respect:

- Provided the accumulation refers to “old positions“ (i.e. acquired before 2009) sold before April 30th, the bank might still be obliged to deduct AGS on the accumulation, since the disposal as such was not subject to AGS.
- The deferred tax deduction on foreign fund accumulations increases the complexity of the capital gain calculation formula even more. Since accumulations are generally to be considered as correction value within this formula, the deferred taxation might result in the necessity of implementing different rule sets on position level, depending on the date of disposal (before / after April 30th).
- What options does the bank have, if the tax figures for an accumulation will not be published until April 30 (legal publication deadline might be extended to 8 months in some scenarios)?

The drafted guidelines also contain some statements on loss consideration, but do not provide guidance on whether this only refers to a respective refrainment from future tax withholding or could also result in a retroactive compensation of taxes already withheld („tax optimization“). Provided such tax optimization will be permitted (as in the onshore-case) it must also be regulated, whether such tax credits will be limited to taxes formerly withheld by the bank itself, or will also include taxes already withheld abroad in Germany.

Example: German dividend (taxes already deducted by Clearstream, Germany)

- ⇒ Client with unused loss-pot balance: will the bank be entitled to use the loss-pot for compensating the client in cash for taxes formerly withheld in Germany?
- ⇒ Client opted for church tax deduction: will the bank be entitled to compensate the client in cash for the decrease in taxes formerly withheld in Germany resulting from the church tax deduction?

Further, the draft currently does not contain comprehensive statements regarding the handling of corrections:

- Are corrections to be considered for AGS-purposes, resulting in a respective amendment of past tax bookings?
- If yes: must the bank differentiate between internal and external mistakes? Such differentiation is required within the German final levy taxation system (onshore), since internal mistakes can there be amended with retroactive tax-effect, whereas external mistakes can only be amended with effect on the correction date and for the amount of the difference between the original and the corrected booking („delta correction“).

Another important open issue refers to the future interaction between the EU savings tax directive (“ESD”) and AGS. Since the formerly intended procedure of crediting the ESD tax on the AGS and subsequent cash compensation of the residual amount to the client was rejected by the EU-Commission, the intention is now to exclude interest income subject to ESD taxation from the AGS (not considered in the drafted guidelines so far). Such an exemption would result in various issues on the implementation side. Whereas an exclusion of bond coupon interest might be done easily, the handling of account interest could be more challenging. Currently no ESD tax is effectively withheld on account interest due to the already deducted 35% Swiss source tax. Should account interest therefore be refrained from future AGS deduction or (since no effective ESD-tax deduction is made) shall account interest become subject to AGS on top, with potential crediting 15/35 (%?) of the Swiss source tax withheld?

However, the biggest challenges are to be found in the fund area:

- Fund income: Since fund accumulations are not subject to ESD so far, they will become subject to AGS. In contrast, fund distributions are already subject to ESD regarding the interest portion (TID), resulting in a respective exclusion from AGS. As the other portions of distributed taxable income (especially the dividend portion) shall then solely become subject to AGS, this would not only result in a different tax burden depending on the type of distributed income, but also lead to differences in the tax burden on the interest portion depending on the funds distribution policy. In addition, also potential differences in the definition of interest income between ESD and AGS might have to be considered.
- Fund disposal: Provided the fund is “ESD in-scope” only the portion of the unit price referring to interest income (TIS) will be subject to ESD. However, the AGS relevant taxable capital gain might be (significant) higher. In such case a comparative calculation might be required in order to determine a potentially additional AGS deduction. In such case it would also be required, that any future correction of former ESD calculations will subsequently result in respective amendments of the AGS calculations as well. Positions acquired before 2009, which are not subject to AGS, would then still be subject to ESD, resulting in respective tax disadvantages for the client.
The disposal of funds, which are “ESD out-of-scope”, would then be solely subject to AGS.

The drafted guidelines do also comprise several statements on the handling of corporate actions under the AGS rules. However, from our point of view these statements are not only still lacking clarity in several aspects, but do also often refer to the respective responsibility of the data provider (=> SIX Telekurs) for the tax-wise required information. It is currently not clear, whether all this important German tax related information required for the correct AGS processing can be provided and implemented within the various systems in time.

Compensation taxation of previously untaxed wealth

Under consideration of the recent changes on the handling of inheritances within the tax treaty between Switzerland and the United Kingdom it is currently intended to adjust the tax treaty between Switzerland and Germany accordingly. Besides the discussed implementation of a higher special tax rate it is still unclear, how future inheritances should be handled. Based on current political pressure in Germany there are also tendencies to increase the general tax rates for the compensation taxation for the past significantly.

Based on these latest developments it could be assumed that the opting for compensation taxation will lose its “attractiveness”, which in turn might result in an increased attractiveness of disclosing the past towards the tax administration (i.e. opting for “amended” tax assessment).

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