LEDGENDA

Information Bulletin Nr. 18
December 2009
Legal and tax information newsletter of the Ledgis Network
www.ledgis.com

Summary

2 In Switzerland, **banking secrecy** protects client privacy under all angles of a banking relationship, but is not absolute. A client may waive it or banking secrecy may be lifted by law or as a result of a judicial or administrative order.

4 On March 13, 2009, **Switzerland** announced that it would review its international cooperation policy in tax matters to implement **OECD standards** governing administrative assistance pursuant to article 26 of the OECD Model Convention (the Convention). From September 1, 2009, it has signed or initialed **14 agreements** which eliminate the "dual incrimination" principle and the distinction between tax evasion and tax fraud as well as the banking secrecy defense.

7 Agreements entered into by **France** with Switzerland, on the one hand, and Liechtenstein on the other hand, respectively in August and September 2009, shall enter into force as of January 1, 2010 and shall dramatically change the scope of **exchanges of financial and tax information** with those two States.

10 Advisers, trust companies and financial institutions, whether French or foreign, may incur a **criminal and financial liability** as joint perpetrators or aiders and abetters as a result of recommendations or services provided to clients found guilty of **tax fraud** in France.

12 Swiss attorneys at law are bound by **professional secrecy** rules which fully protect their clients facing tax assistance requests, provided they strictly act within the framework of their litigation or advisory duties.

Swiss banking secrecy and limitations thereof

The right to banking secrecy protection primarily results from the **right to privacy** provided for by both the Federal Constitution and civil law. The **Federal law** governing data protection also contains certain provisions protecting personal data. Finally, **contractual terms** between a banker and a client generally provide for a duty of the banker to keep confidentiality as regards client relationships.

The purpose of banking secrecy is not to protect the secrets of a banking institution but to safeguard the privacy of clients, the latter being the sole holders of the right to secrecy.

There is no legal definition of banking secrecy. It covers all transactions carried out or contemplated by a bank; it prohibits not only disclosure of the identity of a person or legal entity, whether or not a client of a bank, but also disclosure of information entrusted to it by such persons or entities pertaining to their financial position and relations with third parties. The very existence of a business relation between a bank and a client as well as any piece of information related thereto is covered by banking secrecy.

Criminal penalties may be imposed for violation of banking secrecy and include imprisonment for up to three years or a fine. Violations by negligence may result in a fine of up to CHF 250,000 while for legal entities (including banks) the fine may reach CHF 5 million.

Banking secrecy is **not absolute** and is quite often limited by contractual provisions, such as those enabling a bank to carry out SWIFT transfer orders or other Internet transactions. It is also limited by law or may be **waived** by a client or lifted as a result of a judicial or administrative order.

Generally speaking, limitations of banking secrecy comprise the following:

– in the case of founded suspicion of **money laundering**, a financial intermediary has a duty to report it spontaneously to the Money Laundering Control Authority;

– as to **civil matters**, a judge may order a person's spouse or his/her bank to disclose information and documents relating to his/her assets and income; heirs of a deceased client of a bank are entitled to receive information

as to the value of the accounts
of the decedent at the date of death,
or even further back in the case of
«forced heirship», subject to certain conditions;

– as to **debt collection proceedings**, in cases of seizure, bankruptcy or attachment, under certain circumstances, a bank may be under a duty to disclose information to the Debt Collection Office;

– in the context of **international assistance proceedings in criminal matters**, banking secrecy may be lifted, provided the relevant charge is considered as a criminal offence under the laws of both the requesting State and Switzerland and further provided that in the requesting State, information and documents so transmitted may not be used for purposes of investigation or evidence of an offence for which no assistance may be extended;

– in certain Cantons, a banker may be under a duty to testify as a witness on matters covered by banking secrecy; that rule shall be extended to the whole of Switzerland when the Federal Civil Procedure Code comes into force, which is expected to occur in 2012;

– information may be disclosed to foreign financial market supervision authorities in **administrative assistance** proceedings pertaining to insider trading or price manipulation;

– for the exclusive purpose of **consolidated supervision** of a group of companies, Swiss subsidiaries of foreign banks may be authorized to transmit abroad certain data covered by banking secrecy;

– in **fiscal offence** matters, an exchange of information may also occur under certain conditions.

Our opinion

Originally enacted by the Federal Law on Banks in 1934, banking secrecy has since continuously eroded to adapt to societal changes and international pressures. Today, the biggest breaches may be noticed in tax rather than in civil or criminal matters.

However, even though banking secrecy may be lifted by law or Court order, the information recipient authority may not use it in its discretion. Information is transmitted for a specific purpose and may not be used for other ones.

Banking secrecy therefore retains its full relevance as an efficient protection of client privacy.

Swiss point of view: exchange of information in tax and financial matters

By threatening Switzerland and other States to include them in a “black list” of non-cooperating States, OECD exerted pressure on those States in order to induce them to comply with its own standards. It imposed on Switzerland the obligation, under threat of penalties, to enter into twelve conventions implementing those standards before the end of 2009.

1. Tax evasion or tax fraud

Up until now, Switzerland has expressed reservations about paragraphs 1 and 5 of article 26 of the Convention: it reasoned that the primary purpose of international tax agreements was to fight against **double taxation, not tax evasion**. Thus, Switzerland has always limited administrative assistance to those pieces of information required for the enforcement of the Convention’s provisions, not of those of the domestic legislation of a requesting State. Switzerland was prepared to provide information exchange in view of the application of domestic legislation in very limited cases of **fraud carrying a possible prison penalty** under the laws of both contracting States (principle of “dual discrimination”).

Based on this principle and on its domestic legal distinction between tax evasion and tax fraud, Switzerland has always refused to disclose tax information in matters regarded as evasion. This restrictive Swiss interpretation varies depending on the relevant double taxation agreement. The concept of “tax fraud” has been thus somewhat extended over the last years in the course of new treaty negotiations.

2. Neutralization of § 5 of article 26 of the OECD Model Convention

This paragraph provides that a requested State may not refuse to disclose information solely for banking secrecy reasons. Switzerland, within the framework of consultations on the 2000, 2003 and 2007 Reports on disclosure of banking information for tax purposes, had notified OECD that it had little or no ability to obtain such information because of **banking secrecy rules provided for in its domestic legislation**.

That doctrine shall come to an end as from January 1, 2010, when the first amended double taxation treaties come into force (subject to a possible popular vote). The new rules of administrative assistance in tax matters pursuant to OECD criteria shall then become fully applicable.

In the light of the first publicized revised conventions, i.e. amendments signed with Denmark, France, Luxemburg and Norway, it appears that concerns voiced by the banking community about administrative assistance were partially satisfied. Switzerland, in these new texts, received **guarantees** on the following points:

i. To limit (except as far as France is concerned) administrative assistance to information relevant for taxation of income and private wealth in the requesting State — i.e. the only taxes covered by the Convention — all other taxes excluded.

ii. To guarantee non-retroactivity: the amendments provide that any information request shall refer to tax years beginning after January 1 of the year following the coming into force of the Convention.

iii. To forbid "fishing expeditions", i.e. requests for information based on no evidence or clue whatsoever. Furthermore, a requesting State shall identify the taxpayers targeted by a request, specify the relevant period, describe the pieces of information sought and specify the tax purpose of the request, as well as identify the banking institution or any other person, including trust companies, accountants, company directors and other service providers in possession of such information.

Important note regarding the Switzerland-France Amendment: this Amendment provides that France shall be under a duty to specify the person(s) believed to be in possession of the requested information (including banks) only to the extent it has knowledge thereof. As far as Switzerland is concerned, the competent authorities might regard such request as a "fishing expedition" for which no assistance might be provided.

iv. To limit strictly the exchange of information to that covered by the **request** excluding any automatic or spontaneous exchange of information.

v. To recognize a fundamental right to due process rules of the requested State. Thus, for each administrative assistance request notified to Switzerland, the relevant taxpayers shall have a right to state their case and to appeal.

Switzerland solved the legal problem of access to banking data by providing in the text of the Convention that the requested State has power to obtain such information notwithstanding any limitation resulting from domestic law. The advantage of this solution, inspired by the Convention between Belgium and the United States, is that Swiss law governing banking secrecy remains untouched.

Our opinion

The economic crisis and the significant debt of Western States made tax evasion untenable among OECD States.
As a result, Switzerland, following the example of Luxemburg, Belgium and Austria, elected to **implement the OECD standards**. For numerous observers, this is a dramatic breach in banking secrecy and a departure from the Swiss traditional approach regarding the fight against tax criminal offences.

On September 1, 2009, Switzerland had already signed five agreements (with France, Denmark, Luxemburg, Norway and Spain) and initialed ten more. In negotiating these new agreements, it obtained guarantees regarding the main fears of banking communities.

Switzerland was not the only State compelled to review its administrative assistance policy. Non-Treaty, so-called «tax haven», countries such as the British Virgin Islands or Channel Islands are also experiencing pressures from the OECD. These States were forced to enter into tax information exchange agreements implementing standards similar to those of article 26 of the Convention. They shall also enter into force as of next year for most of these States.

French point of view: exchange of information in tax and financial matters

Following the London G 20 summit meeting (see Ledgenda Nr. 17, entirely focused on that subject), France signed, or is about to sign, tax cooperation agreements with numerous States which are regarded either as pure «tax havens» (Jersey, Guernsey, Isle of Man, British Virgin Islands, Bahamas, Cayman Islands, Andorra or Liechtenstein) or as countries not enforcing international standards of information exchange (Belgium, Switzerland and Luxembourg).

While negotiating these new Treaties, or amending the existing ones, France endeavored to cause clauses to be adopted optimally implementing internationally recognized standards as contained in article 26 of the OECD Model Convention, which are poised to become a universal reference.

This **Ledgenda Nr. 18** analyzes the amendments to the **France-Switzerland** agreement, signed on August 27, 2009 and the agreement signed between **Liechtenstein and France** on September 22, 2009, both covering **the exchange of information in tax matters**.

1. Scope and form of exchanges between States

Exchanges may take **three forms**: exchange upon request, spontaneous exchange or ex officio exchange.
Both agreements signed with Switzerland and Liechtenstein provide that only **exchange upon request** is permissible, provided it complies with the formal requirements.

France is entitled to support its requests by specifying «only» the name of the targeted taxpayer, the period covered, the information sought and the tax purpose of the request, without having to mention the name of the banking institution or the account particulars of the relevant taxpayer.

Requesting authorities — practically speaking, French ones — is henceforth entitled to receive information held by financial institutions, professionals or any person acting as agent or trustee **without opposability of the banking secrecy**.

The agreement entered into with Liechtenstein even specifies that France shall be entitled to receive, possibly through local inspections (article 6: Tax Investigation Abroad), information regarding:

- legal and beneficial owners of companies, establishments («Anstalten»), collective investment vehicles and other entities; and
- as far as foundations are concerned: founders, members of the foundation's board and its beneficiaries; and
- in the case of trusts: settlors, trustees, protectors and beneficiaries.

2. Confidentiality of exchanges

Agreements signed by France with Switzerland and Liechtenstein both follow the OECD Model and provide that all information collected within the framework of exchanges of information shall be kept confidential and may be transmitted only to persons or authorities entrusted with tax assessment or collection.

In this context, information collected during exchange proceedings should be notified to taxpayers or their counsel; yet experience shows that French tax authorities are not eager to enforce such notice requirements. There shall therefore be a need to demand such notification in due time so as to prepare a taxpayer's defence based on all known facts.

3. Advantages

The amendment and the agreement entered into by Switzerland and Lichtenstein shall enable both States to benefit henceforth from "advantages" reserved by French domestic law to cooperative countries, namely:

- French resident individuals receiving dividends from a Swiss or Liechtenstein source shall be entitled to a 40% deduction (same as for dividends received from French or European companies);
- French "PME" (small businesses) having branches or subsidiaries in those countries shall be entitled to claim a tax deduction for losses suffered by such branches or subsidiaries;

- As regards the 3% tax, Swiss or Liechtenstein entities may claim its exemption against the disclosure of their shareholders;
- The benefit of a tax deferral for securities reclassification or capital restructuring transactions (contribution in kind, merger, spin-off), provided all other conditions are fulfilled.

Our opinion

The signature of these Treaties shall dramatically change relations between France and those formerly non-cooperative countries.

For the Treaties entered into with Switzerland and Liechtenstein, changes are expected to become effective as of January 1, 2010, irrespective of the date on which they shall come into force, as an independent date is provided for the start of exchange of information proceedings. One may therefore expect that France shall begin to issue information requests to its Swiss and Liechtenstein counterparts already in 2010 for wealth tax, but from 2011 only for income tax purposes.
In principle, information remitted to France shall cover only tax and calendar years beginning on January 1, 2010.

French criminal and tax liability of advisers, whether French or foreign

Many **intermediaries** may act as advisers as regards the holding and/or restructuring of assets held by French residents.

1. Under French tax and criminal law, all such intermediaries — whether individuals or legal entities — may be held **joint perpetrators or aiders and abetters of a beneficial owner** (taxpayer) and criminally convicted under the general offence of tax fraud (article 1741 of the Tax Code, "Code Général des Impôts").

This article provides that "whoever fraudulently evaded or attempted to evade assessment or total or partial payment of taxes, whether having willfully omitted to file a return within the prescribed time-limit or willfully failed to disclose a portion of sums liable to tax (…), may be sentenced, apart from applicable tax penalties, to a fine of € 37,500 and to five years in prison." The applicable threshold stands at an amount of tax evaded of € 153.

2. As to aiding and abetting, any person who willfully aided and abetted a taxpayer to evade a tax of more than € 153 is liable to being convicted as an offence perpetrator (article 121-7 of the Criminal Code – "Code pénal"). Legal entities face a possible fine five times as high as that of individuals (article 131-38 of the Criminal Code). Under the French doctrine of **territoriality of criminal law**, aiding and abetting may be established when any one of the constitutive elements of an offence was committed on **French territory**. Thus whenever an act of tax fraud is perpetrated in France, French courts are competent, even where a foreign person aided and abetted from abroad (French Supreme Court in criminal matters, "Cass. crim.," March 13, 1981).

Likewise, French criminal law is applicable to aiding and abetting to commit a foreign tax fraud if that offence may constitute a crime under both French and foreign laws and the fraud was established by final judgment of a foreign Court.

Under administrative doctrines (incorporating compelling provisions of the Criminal Code), aiding and abetting implies three elements:

- a principal offence (failure to report assets or income);
- a willful association between the perpetrator and the aider and abetter;
- a positive action of the aider and abetter (provision of material, help and assistance) performed before, or simultaneously with, the offence.

Case law defines aiding and abetting as the provision of means or structures aimed at concealing income from the tax administration.

3. Advisers sentenced under a tax fraud final judgment may also be jointly and severally liable with the taxpayer for payment of the evaded tax and of eventual tax penalties (article 1745 of the Tax Code).

Our opinion

During the course of their activities, attorneys shall solely assist or advise their clients through representation in **litigation matters** (criminal or administrative jurisdictions, tax investigations, etc.) or **preparation of legal opinions**.

In such cases, they shall incur no tax or criminal liability for legal proceedings initiated by their clients or against the latter or for legal opinions in compliance with the ethical rules of the profession.

Switzerland: professional secrecy of attorneys and tax assistance

Attorneys at law practicing in Switzerland are subject to **professional secrecy** as a result of their Code of ethics and of the Federal law governing free movement of lawyers (article 13 thereof).

Any violation of that principle through unauthorized disclosure of information covered by professional secrecy (information obtained during the course of activities as an attorney) is a **criminal offence** (article 321 of the Swiss Criminal Code).

This rule, which does not apply to bankers, portfolio managers, auditors or trust companies, constitutes the best **protection for clients**.

The question is whether Swiss attorneys and authorities shall continue being able to refuse to disclose confidential information on the basis of this principle when the new Double Taxation Agreements (DTAs) shall have entered into force (assuming to be January 1, 2010). One has to bear in mind that these DTAs benefit from a legal standard which supersedes that of domestic State law.

Conventions drafted in compliance with OECD standards include a **provision limiting the obligations of a requested State**, by reference to § 3 of article 26 of the Convention governing assistance in tax matters.

This limitation is applicable where the requested information is likely to disclose any **trade, industrial or professional secret** (lit. c).

Treaty law thus creates a substantial **legal filter** for exchanges of information between States, which grants a protection to the clients of an **attorney** who acted in such capacity in litigation or advisory matters.

This includes the analysis of the client's legal position in order to enable the client to decide on a possible course of action regarding his/her issues.

Conversely, professional secrecy does not cover:

- documents remitted by a client to his/her attorney for the purpose of avoiding a disclosure prescribed by law or by a treaty;
- information obtained by an attorney in another capacity : shareholder, agent, trustee, settlor of a trust, portfolio manager for a client's assets, company director; in the latter case, secrecy covers only information received in the framework of the mission entrusted by a client (thus excluding information obtained in the course of administration of the relevant company).

Our opinion

Hierarchy of legal rules establishes a preeminence of international law (including DTAs) over domestic law.

However, as to the scope of professional secrecy of tax lawyers, the protection they may offer to their clients under domestic Swiss law is much greater than that of other professionals (agents, auditors, trust companies, banks, etc.)

Furthermore, in case of legal ambiguity, vagueness or conflict of rules, **professional secrecy of lawyers shall prevail.**

Member firms

CLC	FBT		CYL	
65 avenue Marceau	Rue du 31-décembre 47	Avenue de Rhodanie 60	6 place de la République	197 boulevard
F-75116 Paris	CH-1207 Genève	Case postale 151	BP 258	Saint-Germain
Tél. +33 1 47 20 72 72	Tél. +41 22 849 60 40	CH-1000 Lausanne 3 Cour	F-14013 Caen Cedex 1	F-75007 Paris
Fax +33 1 47 20 72 70	Fax +41 22 849 60 50	Tél. +41 21 711 71 00	Tél. +33 2 31 86 36 00	Tél. +33 1 45 44 01 07
clc@clc-avocats.com	info@fbt.ch	Fax +41 21 711 71 50	Fax +33 2 31 50 33 20	Fax +33 1 45 44 62 31
www.clc-avocats.com	www.fbt.ch	www.fbt.ch	www.cyl-lex.com	cyl@cyl-lex.com