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Briefing

Final withholding tax: money instead of data

The UK and Germany have committed to negotiations with Switzerland on a final withholding tax. The planned tax would cement Swiss banking secrecy and undermine the EU's common struggle for international tax transparency. Civil society urgently needs to oppose the proposed agreement.

Mark Herkenrath, 28.10.2010

The declaration of intent issued on 27 October by Germany and Switzerland lays the groundwork for negotiations on a new tax agreement. According to a press release by the Swiss Federal Cabinet, what this entails is a one-off retroactive tax and a regular final withholding tax in the future. On the one hand therefore, the intention is to agree to a one-off retroactive tax on undeclared funds from the past, and on the other, to a recurrent withholding tax on all future income on capital in Switzerland.

The declaration of intent by Switzerland and Germany is not accessible on the websites of the Swiss authorities. What is nonetheless clear is that Switzerland would transfer these two withholding taxes anonymously to the German tax authorities, thereby protecting banking secrecy. In return, the assets and income would be fiscally "covered", in other words whitewashed, and would no longer need to be declared in Germany (see the Swiss Ministry of Finance Fact sheet on the matter). Switzerland expects that with such a solution "the automatic exchange of information will no longer be an issue in relations between the two States".

Opposition pays off...

According to a press release by the Federal Cabinet, the UK concluded a similar agreement with Switzerland on 25 October. Yet the Joint declaration makes no mention whatsoever of the final withholding tax. It merely states that in the preliminary talks both countries had reached sufficient understanding on which basis to initiate formal negotiations on a new tax agreement towards the end of the year. The negotiating mandates are yet to be laid out in detail.

The situation is similar for the agreement with Germany. The *Neue Zürcher Zeitung* (NZZ, 28.10.2010, p. 27) notes that "the upcoming negotiations must still clarify some points and *failure is still a possibility.*“ Political parties and NGOs are therefore still in time to influence the negotiations and to generate critical public opinion. They should seize this opportunity as a matter of urgency. On the Swiss side, the appropriate Parliamentary Commissions are to be consulted about the negotiating mandate.

Undermining EU solidarity

The only express aim of the joint declarations agreed by Germany and the UK with Switzerland is extended cooperation on tax matters that has "an equivalent effect to the outcome which would be achieved through an agreement to exchange information automatically". This means that for those two countries, automatic exchange of information with Switzerland is off the agenda for the time being. They are thus undermining the joint EU approach to the struggle to achieve international tax transparency. The new model conflicts with EU Tax Commissioner Semeta’s recently expressed commitment to automatic information exchange as the most important policy goal. Rumours are that Spain and France are now interested in a final withholding tax. The new model could therefore spread rapidly.

According to NZZ-reports (28.10.2010, p. 27), however, the EU Commission is unruffled. It emphasizes that bilateral agreements between EU States and Switzerland may not infringe either the European Directive on Savings Income Taxation or the Agreement on the taxation of savings income between the EU and Switzerland. Bilateral arrangements concerning a withholding tax can therefore be made but the taxation of interest payments at source in Switzerland may not fall below the tax rates set in the existing agreement on the taxation of savings income (currently 20 per cent, and 35 per cent from mid-2011 onward). Neither was it being assumed that the UK and Germany would henceforth be actively resisting EU plans aimed at automatic information sharing.

Financial incentives

There are financial reasons why Germany and the UK are taking an interest in a final withholding tax on old undeclared assets and on new interest income. According to the *Basler Zeitung* (BaZ, 14.10.2010, p. 7) and the *SonntagsZeitung* (SoZ, 24.10.2010, p. 57), under the planned agreement with Germany, insiders assume a tax rate of 25 per cent for new interest income and 25-30 per cent for undeclared assets that have been in Switzerland for over ten years. Such old undeclared German funds are estimated at 200 to 300 billion francs (150-220 billion euros).

Twenty-five per cent on 200 billion francs yields 50 billion francs (37 billion euros) in tax revenue that would flow into German government coffers at one go. Bank Sarasin nevertheless advises its German customers to make voluntary declarations (BaZ, 14.10.2010, p.7): for now, the applicable German penalty tax for those making voluntary declarations would cost them less than the planned retroactive withholding tax.

No substitute for automatic information exchange

Yet the final withholding tax cannot replace automatic information exchange. For there is the danger that it may be circumvented by shifting undeclared assets to financial centres such as Singapore or Hong Kong, where no such taxes are assessed. Besides, the UK and Germany seem to suspect that there may be other possibilities for circumvention. They therefore want provision for extended administrative assistance – i.e. information exchange upon request – to be firmly anchored in the envisaged agreement.

Administrative assistance upon request is nevertheless associated with major administrative hurdles. The tax authorities must justify their suspicion of tax evasion and furnish detailed information about the suspect. They are generally able to do this only if they are in possession of "stolen" information. Switzerland has therefore built into its Administrative Assistance Ordinance – soon to be converted into a law – the rejection of administrative assistance when stolen bank data is involved. In many cases only automatic information exchange could produce the data that is made the prerequisite for information exchange upon request.