The UK-Swiss tax agreement: doomed to fail
Why the deal will raise little, and may be revenue-negative for the UK

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1. SUMMARY

2. BACKGROUND

2.1 The basics of the UK-Swiss deal
2.2 Swiss bankers designed this, to derail European transparency
Box 1: European Savings Tax Directive
2.2.1 Switzerland was becoming more transparent – now the shutters are down again
2.2.2 The deal fixed the wrong loopholes

3. THE ESCAPE ROUTES

3.1 Escape Route 1: foundations and discretionary trusts
Box 2: structures with no beneficial owner
3.2 Escape Route 2: insurance wrappers
3.3 Escape Route 3: exemptions for various structures
3.4 Escape Route 4: using foreign jurisdictions – Swiss bank branches
Box 3: Branches and subsidiaries
3.5 Escape Route 5: types of income
3.6 Escape Route 6: Swiss trustees of foreign trusts.
3.7 Escape Route 7: insurance, loans
3.8 Escape route 8: inheritance taxes
3.9 Escape route 9: timescale
3.10 Escape route 10: avoiding the abuse clause

4. FURTHER OBJECTIONS

4.1 Objection 1: the published numbers make no sense at all
4.1.1 How 'efficient' was the EU STD in collecting tax on UK residents' Swiss assets in 2010?
4.1.2. Would the UK-Swiss deal deliver a higher or lower share than the EU STD?
4.1.3 How much will the UK expect to earn on the future income?
4.1.4 How much will the UK expect to earn on the capital charge?
4.1.5 Why has the UK promised far higher revenues?
4.1.6. Knock-on effects on other tax havens make this deal worse
4.2. Objection 2: Swiss bankers cooked this up: a bad, deceptive deal.
4.3 Objection 3: The deal may fall foul of UK law
4.4 Objection 4: The deal is likely to fall foul of EU law
4.4.1 Not nearly equivalent to automatic information exchange.
4.5 Objection 5: The '500 requests per year' is a smokescreen
4.6 Objection 6: Will the Swiss tell the UK where the money has gone?

5. A BETTER WAY TO PROCEED

5.1 The EU Savings Tax Directive amendments
5.1.1 Tackling Escape Route 1: foundations, discretionary trusts etc.
Box 4: The EU amendments and Paying Agent Upon Receipt
5.1.2 Tackling Escape Route 2: commercial, manufacturing companies etc.
5.1.3 Tackling Escape Route 3: branches in Singapore etc.
5.1.4 Tackling escape route 4: Categories of income
5.1.5 Tackling Loophole 5: Swiss trustees of foreign trusts

6. TALKING POINTS

6.1 The effrontery of those selling these deals is galling
6.2 This is a source of shame for the British accountancy profession

1. SUMMARY

The UK has just signed an agreement with Switzerland under which Swiss banks promise to withhold some taxes on undisclosed accounts held by UK and German taxpayers, while keeping those accounts secret.

The deal, and another deal with Germany (sometimes known as the “Rubik” deals) has been attacked on many grounds – not least that it provides lifetime immunity (and impunity) to criminals and sabotages longstanding European efforts to set up far more effective systems.

These problems alone are bad enough.

But the agreement, which we show was effectively designed by the Swiss Bankers’ Association, has an even more fundamental failure. It contains loopholes so serious that we believe it will fail to collect even a small fraction of the £4-£7 billion in tax revenues that the UK tax authorities have promised. In fact, because of the knock-on effects, **it may well be that the agreement is overall revenue-negative for the UK in the long run**.

Worse still, some of the biggest loopholes are explicitly carved out of the deal. As a Zurich-based tax adviser noted:

> “This agreement is beyond pathetic. The Swiss banks must be laughing their heads off.”

From about 2008 Switzerland, following decades of resistance to outside pressure for transparency, was at last showing real signs of opening up. Pressure from the United States and the European Union was at long last having the desired effect. But these bilateral deals are destroying European efforts to apply pressure. If these deals are ratified they will constitute a massive victory for Swiss bankers and a terrible defeat for taxpayers of the UK and Germany – and of the wider world.

Switzerland has also signed a very similar deal with Germany and is currently talking to France, Spain, Greece and several other countries, including emerging market nations (enquiries are known as far afield as Uruguay). Britain is apparently looking to expand this to other tax havens such as Panama and the British Virgin Islands. Other tax havens are looking at this as a possible future model for preserving secrecy.

The world now faces a grave risk that this model – guaranteeing financial secrecy while raising almost no new tax revenue – could spread like a cancer through the global financial system.

2. BACKGROUND

2.1 The basics of the UK-Swiss deal

The UK-Swiss deal, signed on October 6th, 2011, essentially guarantees secrecy for tax-evading UK residents using Swiss banks; in exchange, they are supposed to pay a contribution towards back taxes and ongoing taxes.

The deal involves two types of taxes.

First, there will be a one-off, lump sum *capital payment* (to account for evaded past taxes) that will levy 19-34 percent of the average value of the capital over the last 10 years. This is called a "final withholding tax," and once it is paid an individual's past (criminal) tax liabilities are considered cleared.

Renowned lawyers commissioned by Germany's Welt newspaper estimated that the charge will normally be 19%, and only 34% in very exceptional cases, concluding that 'the worst tax offenders will be the happiest ones.' They added:

> Never before did such [unscrupulous people] get such a cheap offer to get off the hook; neither in the amnesty of 2004, nor in the 1980s.

Second, they will incur *withholding taxes on the subsequent income* ranging between 27 and 48 percent annually[1].

The UK government says the deals will raise between £4-7 billion for the UK. As explained in Section 4.1 below, we believe these numbers are wildly over-estimated. The loopholes mean it is unlikely to raise even a tenth of these sums: most likely, all that will be earned is an upfront payment of 500 million Swiss Francs (about £350 million) that Switzerland has promised the UK – a miniscule proportion of the value of the UK assets believed to be stashed in Swiss banks.

2.2 Swiss bankers designed this as a way to derail European pressure

As Section 4.2 explains, this was basically designed by Swiss bankers and then presented to the UK and German authorities for negotiation. It seems certain that the Swiss bankers' primary aim is to play divide-and-rule in the EU and this emasculate the European Savings Tax Directive, a major transparency initiative which was in the process of being powerfully strengthened. (See Box 1.) So far, the tactic has been successful, wreaking havoc on the European project.

> **Box 1: European Savings Tax Directive**
>
> The European Union Savings Tax Directive is, at heart, an information-sharing mechanism. Reflecting years of tortuous political battles – it took 16 years from first discussions in 1989 before finally being implemented in July 2005 – it is a mix of compromises and is far weaker than its original

[1] The Swiss-German deal is almost identical to the UK-Swiss deal, with the main exception being the tax rates levied. Under the German deal, future investment income and capital gains will be taxed at a rate of 26.375 percent, in line with the current flat-rate withholding tax in Germany.

proponents had hoped for.

As it currently stands, participating members agree to share information with each other about interest payments received by each others' citizens, so that each country can tax their own citizens' interest income appropriately. Recalcitrant EU member states such as Luxembourg agreed only to apply a withholding tax[2], instead of automatic exchange of information. In the main, however, it is about information exchange, allowing governments to collect the taxes they are owed. Crucially, it involves the principle of *automatic* information exchange between jurisdictions –the gold standard.

Although the original Directive is full of loopholes and has only collected a small fraction of the originally envisaged sums, it is a long-term work in progress. Major proposed amendments will close the main loopholes and will raise large extra revenues. Before the Swiss bilateral deals, agreement was looking likely to obtain unanimous EU approval in 2011, but this is now uncertain.

An EU directive applies directly to EU members only. However, a number of other jurisdictions including the British Crown Dependencies (such as Jersey) and Overseas Territories (such as Cayman) as well as Switzerland, Liechtenstein and various others have agreed to apply the same or equivalent measures, making a total of 42 jurisdictions. (Details of Switzerland's position as a participating member under the 'withholding tax' option are here. It is widely considered the hardest nut to crack.) All these jurisdictions had little choice but to agree: partly because the EU has made a number of other major agreements on market access and other benefits conditional on their acceptance; and the UK could pressure or force its dependencies to comply.

Luxembourg and Austria have worked hard to derail the move towards full EU-wide automatic information exchange. They have been closely allied with secrecy jurisdictions outside the EU, principally Switzerland, but also supported by various others such as Liechtenstein. (See here for more details on the often subtle dance of politics as these allies have sought ways to derail progress.)

The Swiss banks appear to have 'sold' the "Rubik" deals to the UK public and politicians in two main ways: that it was a 'pragmatic' solution, and that it closed the main loopholes. Both claims are false.

2.2.1 Switzerland was yielding to transparency - but now the shutters are down again

HMRC and many politicians have stated that this is a 'pragmatic' solution and there was 'no chance' that Switzerland would give up bank secrecy. However, this is false. After many decades of iron resistance to external attacks on its banking secrecy, Switzerland had finally just started making major concessions, with promises of more to come. It accepted OECD standards on information exchange, it signed an agreement with the United States that represented a major penetration of banking

[2] The withholding tax has been rising on a sliding scale in recent years and is now at 35%

secrecy – and indeed Swiss Finance Minister Merz said in February last year that Switzerland would have to consider automatic exchange of information:

> "If we want such a (financial services) agreement, we have to be prepared to take on European rules -- and Europe has the automatic exchange of information. . . At some point we have to hold this discussion."

As explained above, and as Merz says, the European Union and its member countries have enormous leverage over Switzerland: they can wield the enormously powerful threat of denying market access and use other levers. In 2004 Germany clamped down on cross-border traffic with Switzerland as a powerful signal of its influence.

So Switzerland was just on the point of opening up. These deals were designed by Swiss bankers (as explained in Section 4.2) specifically to derail the far stronger EU agreement, which would have collected serious amounts of tax for the first time ever.

2.2.2 The deal fixed the wrong loopholes

The second way they 'sold' this deal, politically speaking, was to point to loopholes in the Savings Tax Directive, and promising to fix them. However, what the deal does is to plug its least important loopholes (such as the fact that dividends, and capital gains are excluded from its scope) while carefully leaving intact the most important albeit less obvious loopholes (regarding manipulating beneficial ownership through the use of discretionary trusts, foundations, insurance wrappers and offshore companies; see Section 3). This simple but deceptive message that 'it will fix loopholes' was probably fairly easy to sell to officials and politicians in Germany and the UK. As the same Zurich tax adviser noted:

> "The UK and German negotiators got the wool pulled over their eyes by the Swiss."

Not only are the loopholes in the UK-Swiss deal catastrophic, but by definition a bilateral deal covers only two countries. By contrast, the EU scheme effectively covers not only the 42 jurisdictions, including most of the world's big tax havens, but also (as Section 5 explains) accounts held anywhere in the rest of the world but managed from these 42 countries. This makes the UK-Swiss scheme far weaker than the EU alternative, which the Rubik deals are in the process of sabotaging.

This article outlines the main loopholes in the UK-Swiss agreement; it explains how the forecast numbers are wildly over-optimistic; it explores legal and other objections to the deal; then it describes how the European alternative would work far better –by collecting more money, by proving a proper avenue towards properly breaking open Swiss secrecy once and for all, and potentially providing a tool for tackling secrecy far beyond Europe.

This is written from the perspective of the UK-Swiss deal, but since the German deal is almost identical to the UK one it is also applicable to the German deal. This analysis is of course relevant for all those countries that are considering similar deals with Switzerland.

Unless Germany, the UK and Switzerland can demonstrate decisively that our arguments are wrong, the deals must be killed, and no new details can be supplied.

3. THE ESCAPE ROUTES

Since the European Union Savings Tax Directive was first applied in July 2005, it has collected a tiny fraction of the originally envisaged sums. For instance Jersey, with £165 billion in bank deposits alone, paid out just £4m last year under the scheme, a miniscule fraction of what one might expect based on reasonable rates of return and prevailing tax rates. Section 4.1 below explains why the UK-Swiss tax agreement will collect a similarly small percentage of the envisaged £4-7 billion, essentially for the same reasons.

This section explores the loopholes and escape routes. Section 5 looks at how the EU will plug the holes.

3.1 Escape Route 1: foundations and discretionary trusts

The UK-Swiss agreement explicitly creates a carve-out for foundations and discretionary trusts, the bread and butter of criminals and tax evaders. Box 2 explains the basics.

> **Box 2: structures with no beneficial owner**
>
> A trust holds assets for beneficiaries, to be managed by trustees (to understand the deviousness of offshore trusts, see this primer on trusts.)
>
> The innovation in a *discretionary* trust is that the beneficiaries are not fixed. Instead, the question of who is to benefit from the assets is left to the 'discretion' of the trustees. So you might have several potential beneficiaries – some could even be children who have not even been born yet – and at least for now, nobody is entitled to the assets or their benefits until the trustee uses his or her 'discretion' (another highly slippery concept, especially when wielded by an offshore trustee) and shells out to that particular person at some point in the future. Behind these arrangements, undisclosed to anyone but the trustees, there will be a set of instructions about how to manage the assets, sometimes called a 'letter of wishes' or 'bylaws' that only the (criminal) person who established the structure, and their trustee, will know about.
>
> So until the payout happens – which may be decades in the future – you cannot know that any given individual was entitled to that benefit: you cannot say who the beneficiary is. There actually isn't one: it's all up in the air, since the trustee's 'discretion' has not yet been exercised.
>
> Foundations, the Liechtenstein *Anstalt* and *Ermessensstiftung,* and other structures, are just as slippery as discretionary trusts, albeit using different mechanisms. The point is, once again, that you cannot identify an immediate beneficial owner. (Another variant involves the Anstalt (Establishment), a

company without shares where it is also impossible to identify owners or beneficiaries.)

END BOX

The significance of all this, from the point of the UK-Swiss deal, was recently explained in The Guardian:

> "Foundations and discretionary trusts are exceedingly slippery. Although someone is always ultimately behind them, from a legal point of view nobody has the rights to their assets. That is the whole point of these things! And if you can't identify who has legal rights to the assets, you can't say if the person ultimately behind it is British, German, Nigerian or Martian. So the bank can't apply the UK-Swiss deal to it and withhold the upfront capital tax."

Now the latest UK-Swiss deal says, explicitly:

> "An individual resident in the United Kingdom is not considered to be a relevant person with regard to assets of associations of persons, asset structures, trusts or foundations, if it is not possible to ascertain the beneficial ownership of such assets, e.g. due to the discretionary nature of the arrangement."
> - *Article 2(h)*

That is an unambiguous and purposeful carve-out from the deal. Its cynicism is breathtaking. This paragraph has been inserted, in order to help a criminal escape the tax by shifting their money into one of these structures. What is more, they can probably persuade themselves that this is done quite legally, because there really isn't a beneficial owner. Curiously, HMRC tackled this loophole with the Liechtenstein Disclosure Facility[3]. It is disturbing to find that it has been left open here.

The German Finance Ministry has formally confirmed the existence of this gigantic loophole (see this article, with a rough web translation here) while, bizarrely, playing down its role.

This loophole on its own drives a coach and horses through the deal. Section 5.1.1 explains how the EU amendments plug this gap.

3.2 Escape Route 2: insurance wrappers

This is another ruse that depends on manipulating the beneficial ownership of assets.

Insurance 'wrappers' are common secrecy and tax evasion tools. Essentially, they place a bundle of assets into a 'wrapper' that is impossible to penetrate. They behave a bit like trusts: investors can place into these 'wrappers' stocks, bonds, funds or virtually any other bankable assets.

[3] By deeming the 'settlor' (or initial contributor of funds to a structure) to be the beneficial owner. See Box 4 for an explanation of how this can be done.

What happens is that the beneficial and legal ownership of the assets is transferred to the insurer (while the funds themselves often remain on the balance sheet of the banks); clients then receive benefits that are tied to the performance of the underlying investment. (They receive not the actual income and benefits, but the 'equivalent' of these benefits.) Clients can also withdraw money from these schemes during their lifetimes either by borrowing from it or other routes[4].

Liechtenstein, Luxembourg, Cayman and Ireland – as well as Switzerland and others – are common purveyors of these schemes, which are increasingly commonplace.

HMRC's Permanent Secretary for Tax, Dave Hartnett said this, in a conversation with John Whiting, Tax Policy Director of the UK Chartered Institute of Taxation:

> "John, you mentioned offshore life bonds. We've a basic principle here which is important and that is where banking assets are held in an insurance wrapper they are caught, but pure insurance investments are not caught."

On the surface, the agreement appears to back him up: Article 2f) says that insurance wrappers are specifically not excluded from the scope of the agreement[5]. However, despite these reassuring words, Hartnett's claim is misleading. In fact, there is a giant loophole here.

This ruse depends on (the same) Article 2f) which also says that

> "relevant assets" means all forms of bankable assets booked or deposited **with a Swiss paying agent** "

If the assets concerned are not booked by a Swiss paying agent, however, then they are not a 'relevant asset' and fall outside the agreement's scope.

In a nutshell, insurance wrappers are moved out of scope by shifting the booking of the assets to the ownership of a foreign insurance company – even though the assets will likely remain with the Swiss bank.

So here is what a tax evading or avoiding UK customer of a Swiss bank would do to escape the tax.

First, move all their assets into, say, a Luxembourg-based offshore insurance wrapper, who the appoints the bank in Switzerland as the custodian and manager of the same assets. That Luxembourg-based insurance company becomes the 100 percent legal and beneficial owner of these assets. Even if the Swiss bank perform due diligence to ask 'who is the beneficial owner?' they will be told, truthfully, that the insurance company is the beneficial owner. The Swiss bank is managing a foreign insurer's assets, not a UK taxpayer's assets. So the assets, and the associated income/benefits from those assets, fall outside the scope of the agreement. No tax is withheld.

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[4] Through early partial redemptions

[5] Hartnett may have believed that this would work, because there are prohibitions on non-Swiss insurance companies being allowed to offer services in Switzerland. However, this prohibition only applies to Swiss residents! It does not apply to, say, UK resident taxpayers.

This is one of the most important loopholes, because this is so easy to do, and insurance wrappers are already so commonplace. (Insurance wrappers can be bought for a fee of 0.5-1.0 percent per year for retail investors, although for the larger fortunes, figures a quarter of that rate are known. This makes them highly accessible.)

Crucially, it is impossible for a bilateral agreement to tackle these structures. Even if other countries wanted to renegotiate such agreements bilaterally, they could not close this loophole. It cannot be done.

Only the EU's Savings Tax amendments, covering 42 of the world's most important tax havens, can tackle this. See Section 5.1.2 below for details.

Among other things, 'beneficial owner' ruses such as these make a mockery of statements by public figures, such as this one, by UK Exchequer Secretary to the Treasury, David Gauke:

> "The agreement with Switzerland was signed on 6 October. It contains a requirement for Swiss banks to look through complicated structures such as trusts and companies to identify whether the beneficial owner is a UK resident taxpayer."

They can still 'look through' these structures and they will find that the owner of the assets is not the person ultimately controlling and benefiting from the structure.

3.3 Escape Route 3: exemptions for various types of structures

The UK-Swiss agreement contains another – again catastrophic, and again explicit – carve out. Here it is:

> "relevant person" means any individual resident in the United Kingdom, who is . . . the beneficial owner of assets held by . . . a domiciliary company (i.e. legal entities, companies, institutions, foundations, trusts, fiduciary companies and other establishments **not exercising a trading or manufacturing activity or another form of commercial operations**);
> *-(Also) Article 2(h)*

The key element is in bold. In other words, the agreement explicitly exempts companies that are categorised as 'commercial' or 'trading' or 'manufacturing.' So if you set up a Panama 'consulting' company or a Hong Kong 'trading' company you will be specifically excluded from the tax deal's scope.

What is more, these are the precise type of vehicles through which undeclared money is typically made and then brought into Switzerland in the first place. So in many cases, these mechanisms will likely be in place already. Swiss bankers, with long experience of this, must have deliberately inserted this exclusion into the agreement (see Section 4.2 for more on this), and HMRC inexplicably accepted these narrow definitions of which entities and arrangements are in the deal's scope.

The EU amendments will bring all these (and other) structures decisively into scope, as explained in Section 5.1.2, below.

3.4 Escape Route 4: using foreign jurisdictions – Swiss bank branches

This is probably the simplest loophole to explain. Customers can simply shift their affairs from a branch of a Swiss bank in Switzerland to its branch in, say, Singapore, which is outside the scope of the deal. See Box 3.

> **Box 3: Branches and subsidiaries**
>
> Swiss banks almost always establish foreign *branches*, rather than *subsidiaries*, in jurisdictions like Singapore, partly because they are cheaper and faster to set up. The difference between a branch and a subsidiary is that a branch is the same legal entity as the head office in Switzerland, uses the same computer systems and its capital assets and liabilities are those of the head office. A subsidiary, by contrast, is legally separate and raises its own capital to stand on its own feet.

Because they are an integral part of the parent company, it would have been technically simple to bring foreign tax haven branches into the scope of the UK-Swiss deal. This missed opportunity is extremely important, and one has to ask why it has been allowed.

The EU Savings Tax Directive amendments do not directly tackle branches.[6] However, the amendments have powerful mechanisms that will go a long way towards patching up loopholes where assets are shifted to places like Singapore or Hong Kong. See Section 5.1.3 for more details.

3.5 Escape Route 5: types of income

The UK-Swiss agreement only includes interest, dividends, and capital gains on what it calls 'bankable assets.' It does not cover other forms of non-capital income such as wages, royalties, income on property, directors' fees, loans, etc.

So when distributions are eventually made (such as from structures described in Section 3.1) the managers (such as trustees and directors) will ensure that the distirbution is made in a form that falls outside the scope of the agreement, such as a loan or a director's fee etc.

See Section 5.1.4 for details on how the EU amendments tackle this.

3.6 Escape Route 6: Swiss trustees of foreign trusts

The UK-Swiss tax agreement focuses purely on *accounts* with 'paying agents' exclusively in Switzerland. So if there is a Swiss-based trustee managing, say, a Bahamas trust with an account in the Bahamas, these fall outside the scope of the agreement.

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[6] It was hard to include this, because its automatic information exchange provisions would force Swiss Head Offices to break banking secrecy in place like Singapore; in contrast the Swiss agreement only withholds taxes and does not require information exchange

Box 4 explains how the EU Amendments tackle this decisively.

3.7 Escape Route 7: Insurance, loans.

Loans can be taken out against any 'tax-deferred[7]' vehicle and never repaid. They can be taken out against assets in a trust, foundation, *Anstalt* and so on.

Insurance 'wrappers' are popular tax avoidance tools, as explained in Section 3.2 above.

Even for those few insurance wrappers provided by Swiss insurance companies – the only types that might fall inside the agreement's scope – it is possible to take out a loan against this insurance wrapper. This loan, which may never be repaid, would a way to receive income outside the scope of the agreements.

The Rubik agreement could have tackled this loophole by deeming unpaid loans as income – but it does not. The EU saving stax amendment tackle this abuse by introducing a new principle of "Paying Agent Upon Receipt" (see Box 4, below.)

3.8 Escape Route 8: Inheritance taxes

The agreement does not address inheritance taxes in any reasonable way.

Inheritance taxes are (Article 9, para 7) subject to the 'clearance' provided by the (19-34%) final withholding tax, meaning that they are supposed to be considered as part of that arrangement, but this is mostly not appropriate, because this capital payment is billed as being a deal "to settle past tax liabilities". Inheritance taxes will not be levied on future income.

What is more, there are no provisions for the ongoing application of inheritance tax.

3.9 Escape route 9: timescale

The deal will not enter into force before May 2013. This is more than ample time for clients and their tax advisers to construct careful pathways around the deal.

One crucial question concerns the up-front capital payment. On the surface, it may seem that those with long-standing past assets in Swiss banks will be captured by this retroactive 19-34 percent capital tax. However, the important part of this is Article 5.1, which is part of the section called "Regularising past assets":

> 1. Subject to paragraph 3 **a relevant person** who is not a non-UK domiciled individual and who held relevant assets with a Swiss paying agent at appointed dates 2 [Dec 31, 2010] and 3 [in 2013, four months after the agreement comes into force] shall have the option either to instruct the Swiss

[7] Many vehicles that sit offshore do not currently pay tax on income or gains. In theory, the beneficiary of such a vehicle should pay tax against those gains once a distribution is made to them (hence the term 'tax-deferred': they don't pay tax immediately, but only later when the distribution is made. In other words, the tax is not paid now but deferred until that later time.)

> paying agent to make a one-off payment in respect of relevant assets in accordance with Article 9 paragraph 2 or to authorise the Swiss paying agent to make a disclosure in accordance with Article 10.

The bit in bold is key. A UK resident can escape this by (as with other loopholes) ensuring that he or she is not a relevant person.

For example, they might escape by shifting their affairs from a branch of a Swiss bank in Switzerland to its branch in Singapore. Although there is a provision for Swiss banks to exchange information with each other if a client moves from one account to another (Article 31, p25), this does not cover a shift to outside the scope of the agreement – to, say, Singapore.[8] Switzerland will only provide bulk information about where the assets have fled to (Article 18); it will not reveal taxpayer details.

3.10 Escape route 10: the weak abuse clause

Article 33 states that

> Swiss paying agents shall not **knowingly manage or encourage the use of artificial arrangements** whose sole or main purpose is the avoidance of taxation of the relevant persons under the provisions of this Agreement in respect of relevant assets.

"Artificial arrangements whose sole or main purpose is the avoidance of taxation" is slippery because trusts, trading companies, life insurance policies, and so on are generally not "artificial" and it can almost always be argued that their main purpose is not to avoid tax. (For example, a trust can be set up to look after future beneficiaries, or provide asset protection from creditors; insurance policies can be legitimately used to provide expedited life cover to beneficiaries outside of probate. And so on.)

This anti abuse clause means little in practice as it only tackles blatant 'sham' schemes bordering on being illegal, such as using nominees as shareholders or directors, agent settlors, or sham (revocable) discretionary trusts and foundations where the settlor is the sole beneficiary and manages the assets indirectly.

4. FURTHER OBJECTIONS

This section outlines how various parts of the agreements fall short of the claims that have been made of them.

4.1 Objection 1: the published numbers make no sense

The estimates below show how it is impossible for the UK to reap anything like the promised sums of tax revenue.

Official and private estimates of undeclared UK taxpayer assets in Swiss accounts

[8] Article 31 only involves a transfer from one Swiss paying agent to the account or deposit of another.- in other words from one Swiss bank in Switzerland to another Swiss bank in Switzerland.

range between £40 billion, p13 here[9]) and £125 billion (though the higher estimates are doubtful, as Section 4.1.6 explains.)

How much would likely be captured by the UK-Swiss deal? The following analysis works in several steps.

First, the only benchmark against which this can be measured is the EU Savings Tax Directive, as applied to Switzerland. As Box 1 explains, this was widely evaded. So we look at the 'efficiency' of the EU Savings Tax Directive in 2010 – how much of the theoretical potential tax did Switzerland collect from UK residents?

Next, we make an assumption and apply that efficiency rate to the relevant assets that are supposed to be targeted under the UK-Swiss agreement, and produce a number, X. That assumption is open to question of course: the UK-Swiss deal covers certain categories of income that are not included in the EU Savings Directive. However, as we will show, that is not fatal to our calculation.

Next, we examine the assumption by asking merely whether the UK-Swiss agreement is likely to have a *higher* or a *lower* efficiency rate than the UK-Swiss deal. It demonstrates that the incentives to escape the UK-Swiss deal are vastly higher than the incentives to escape the EU Savings Tax Directive; as a result, given the gaping loopholes, the UK-Swiss agreement will have a significantly lower efficiency rate than the EU Savings Tax Directive.

The conclusion is then, that X must be the likely upper limit of expected revenues. Section 4 explains that this likely upper limit is £1 billion, and that the real figure is likely to be much lower than that.

4.1.1 How 'efficient' was the EU STD in collecting tax on UK residents' Swiss assets in 2010?

Swiss authorities estimate[10] that in 2010 Switzerland paid the UK about £12.7 million in 2010[11] from taxes withheld under the EU Savings Tax Directive. However, under the EU agreement, Switzerland pays 75 percent of the collected sum and keeps 25% for itself, so this implies that Switzerland actually collected **UK£16.9 million**.

To work out the 'efficiency' of collection, how much theoretically might have been raised? As we noted, we think there may be between £40 and £125 billion of undeclared assets owned by UK residents in Switzerland. However, only about 60 percent of a typical portfolio will contain the kinds of interest-bearing assets that would be covered by the EU Savings Tax Directive[12]. So to judge the 'efficiency,' we need to consider 60 percent of the total undeclared UK taxpayer assets in Swiss banks, i.e. between £24 and £75 billion

[9] CHF 60 billion, or about £40 billion at current exchange rates

[10] For non-German speakers, "Vereinigtes Königreich" means United Kingdom

[11] The revenue was CHF 18.4 million at the prevailing exchange rate. Although the historical average for 2010 was 0.62 per Swiss Franc, the tax is collected at year-end, when the exchange rate was at 0.69. From www.oanda.com

[12] for definitions of what is covered, see Article 6 here

Now suppose, reasonably, an annual rate of return of 3.5 percent on this £24-75 billion sum in 2010, giving rise to annual income of between £840 million and £2.6 billion. The tax rate for the EU Savings Tax Directive was 20 percent in 2010, which theoretically ought to raise between £168 million (if we are talking about £24 billion in assets, earning £840 million at 3.5 percent and taxed at 20 percent) and £525 million (if we are talking about £75 billion in affected assets, earning £2.6 billion and taxed at 20 percent.)

However, the UK only got £16.9 million in 2010. This represents an 'efficiency' rate of between:
a) Ten percent if the total is £40 billion, (ten percent is 16.9/168) and
b) 3. 2 percent if the total is £125 billion (3.2 percent is 16.9/525)

In other words, between 90 and 97 percent was avoided in the case of Switzerland.

4.1.2 Would the UK-Swiss deal deliver a higher or lower share?

As mentioned, this assumption that we can apply the same efficiency rate to the UK-Swiss deal in itself is not robust. However, we can assess whether the efficiency rate would be higher or lower than the 3.2-10 percent efficiency rate achieved under the EU Savings Tax Directive.

To understand this, compare the taxes being applied:

a. The UK-Swiss tax deal involves a 19-34 percent capital tax charge on the average value of the assets held themelves (most analysts reckon the levy will be typically be in the range of 20-25 percent.) It will also levy future taxes of up to 48% on ongoing income.

   So on a £1 million deposit, the capital charge would be **£190-£340,000** plus a tax on the ongoing income of 27-48 percent.

b. The EU Savings Tax Directive as implemented by Switzerland involved a 20 percent tax on *income* (though the rate increased to 35 percent in June 2011). There is no equivalent capital tax.

   A £1 million deposit earning 3.5 percent and taxed at 20 percent would raise **£7,000** per year under the EU scheme.

In other words, the capital charge levied by the UK-Swiss tax deal is massively higher than the EU tax, even if one were to consider a cumulative ten years of ongoing taxation. So the incentive to escape the UK-Swiss deal is significantly greater than the incentive to escape the UK Savings tax[13]. And of course all the loopholes – some at

[13] The Swiss Bankers' Association might try to argue that the UK-Swiss deal should deliver a higher share than this because it expands the categories of income that are covered. However, as explained in Section 2.2 above, these were the least important of the loopholes in the EU Directive. The more important ones remain wide open, with additional carve-outs added. The opportunities to escape are just as large – but the incentives to do so are now much bigger. People are loss-averse; many who may not mind paying £8,000 a year will change their minds when faced with losing a quarter of their capital all at once.

low cost as Section 3 explains – are available to help them escape.[14]

Remember: this is not a representative sample of the UK taxpayer population: we are talking here about people with undeclared assets who had already decided to break the law. A very, very high evasion rate is therefore likely.

So, given the range of vast loopholes and the massively expanded incentives for escape, that share of 3.2 to 10 percent efficiency found under the EU scheme should be considered an upper limit to what might be be recouped from the UK-Swiss deal.

The share is likely to be much smaller, for these and other[15] reasons. Given how widely the relatively small tax applicable under the EU Savings Tax Directive was evaded, it is highly implausible to think that the evasion rate on the capital charge would be any lower.

4.1.3 How much will the UK expect to earn on the future income?

As regards the ongoing income from the UK-Swiss deal, what matters for British taxpayers is the premium over and above what would be delivered by the Savings Tax Directive, otherwise (beyond the capital payment) what would be the point?

We know that the initial capital charge will give a massive incentive to those who have not already sought to evade the EU scheme to find escape routes, which are easily available. Once they have escaped the capital charge, they will almost certainly escape the tax on the subsequent income too.

So it is likely that the UK-Swiss deal will yield a lower share of annual revenue than even the unreformed EU Savings Tax Directive: in other words, it may be revenue-negative from the point of view of income. In addition, there are further revenue-negative aspects from knock-on impacts, as Section 4.1.6 explains. As well as this, if the EU Savings Tax Directive amendments were to be passed, they would plug the major loopholes and raise dramatically higher tax revenues.

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[14] As already explained, evasion of the EU Savings Tax Directive through the use of different categories of income was the least important escape mechanism. The main evasion happened through the arranging beneficial ownership in ways described in detail in Section 3. As an experienced financial commentator put it: when people make investments, they choose their own risk profile, and prefer to stick to this profile and choices. By moving from one category of income to another (say from bonds to equities) they will be altering the risk profile of their investments. It is rare for people to do this for tax reasons – especially when it is perfectly possible to sit tight with the same investments and merely manipulate the beneficial ownership of the asset. "Why would somebody substitute their investment, and change the character of their investment, when they can keep their investment as they want and simply change the beneficial owner?"

[15] First, the catastrophic loopholes will enable anyone who wants to escape it to do so. Second, those affected have already deliberately committed crimes by evading taxes; few will change their attitude, given the easy loopholes available. Those who don't want to break the law can persuade themselves, by using foundations and so on, that they are not technically breaking the law. ("If I do not technically own the assets, then how can I be taxed on them?") What is more, the larger the fortune, the more likely to escape: they will have the greatest incentive to escape the tax, and also the best tax advice. Sources indicate that there are banks in Switzerland where not a single account is held in the customer's own name. The only people with any real likelihood of submitting to the tax are the smaller players with accounts in their own name: these accounts by virtue of their small size will yield relatively little tax revenue.

4.1.4 How much will the UK expect to earn on the capital charge?

a) If there are only £40 billion in total assets involved

In this scenario, as explained above, the EU scheme captures only 1/10th of the relevant assets. If this were the efficiency rate of the UK-Swiss deal, then that rate (at an expected average capital tax charge of 20-25%, applied to the full £40 billion under the UK-Swiss deal) this would raise an absolute maximum upfront capital tax of **£800 million - £1 billion** for the UK**.**

b) if there are £125 billion in total assets involved.

In this scenario, as explained above, the EU scheme captures only 3.2 percent of the relevant assets, which would be £4.0 billion. At an expected average capital tax charge of 20-25%, that raises an absolute maximum of **£800 million - 1 billion.**

(It is no coincidence that these figures from a and b are the same: as the footnote explains, this is an extrapolation from that single figure of 16.9 million[16].

Conclusion: the likely <u>upper limit</u> to total revenues from the capital charge is £1 billion[17].

Given the massively increased incentives for evasion under the UK-Swiss deal, the real figure for UK revenue from the capital charge is likely to be far smaller than this.

Ours appears to be the best possible estimate that can be made, despite the uncertainties involved in forecasting. It is now up to HMRC to explain publicly, and in full detail, how they obtained their much higher estimate.

(Remember also that the initial £500 million upfront payment from Switzerland to the UK (see Section 2.1) is <u>not</u> to be added to that £500 million: additional revenues to the UK would only flow once that £500 million figure has been reached and effectively 'paid off'. Which may be a long time indeed.)

4.1.5 Why has the UK promised far higher revenues?

Statements by Dave Hartnett, the head of HMRC, raise more questions. In an interview by the UK's Chartered Institute of Taxation (CIOT), Hartnett said of the £4-7 billion revenue projection:

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[16] Another way to calculate this would be to take the £16.9 million figure, and then calculate how large the assets would have to be to earn that much tax at a rate of return of 3.5 percent, taxed at 20 percent (the sum is 2.4 billion.) This number represents the 60 percent of total assets – those which would produce the categories of interest that could theoretically be captured by the EU Savings Tax. However the Swiss-UK tax deal applies not just to this 60 percent but (because it expands the categories of income and benefits beyond the categories covered by the EU Savings Tax Directive) applies to the full range of assets. At this 'efficiency rate' would be worth about £4.0 billion (2.4 billion divided by 0.6). Applying the 20-25 percent capital charge to that £4.0 billion would yield £800-£1000 million.

[17] Even if we were to allow for a sudden and robust improvements in world markets and rates of return, which might imply a return to the £40 million obtained under the EU Savings Tax Directive in 2007, we would merely double these estimates, putting the absolute maximum at £750 million. However, this eventuality is considered highly unlikely.

> "We've come at this number in three different ways. The Swiss Banking Association got a big four firm to carry out an assurance process over the Swiss Banking Association's estimate of the amount, and we were party to that arrangement. And that brought out a number in that range. Our analysts in HMRC carried out an exercise and they ended up in that range too. And then we asked other specialists, external to HMRC, to look at it for us, and they were slightly above the range. So that gives us some assurance, I think, that four to seven billion is the right range."

First, he did not say the time period over which this £4-7 billion is expected to be collected, merely that it is the total, not the annual, rate. (It may be true that it would collect this much money over, say, a hundred years.)

Second, as Section 4.2 explains, the Swiss Bankers' Association was the originator of this deal. It is in their interest to commission the 'right' study that will come up with the 'right' number, politically speaking: the more revenues that are forecast from a deal, the more likely a country is to sign.

This argument equally applies to estimates of the size of UK assets in Switzerland; claims that there are up to £125 billion in undeclared UK resident taxpayer assets in Switzerland are to be treated with great skepticism. Other numbers that have been publicly stated in the context of the Rubik deals are wildly inflated[18].

Third, the Big Four accounting firms make a substantial living helping their clients avoid tax. One member of the Big Four has admitted criminal wrongdoing in the recent past for their involvement in criminal tax fraud conspiracies relating to the design, marketing, and implementation of fraudulent tax shelters. It is in the Big 4's interest to overstate the potential financial benefits of this agreement as they will be the organisations likely to make large profits helping clients exploit its manifest loopholes.

Fourth, these estimates were made at a time before the details of the deal had been negotiated and the loopholes would presumably not have been known about. Our estimates, based on the full text of the signed agreement, are sure to be better.

HMRC must publish all of these studies in full so that the public can examine them.

Looking at this from yet another perspective, the UK's agreement is based upon the idea that HMRC (via the Swiss banks) will deduct up to a third from their criminally tax-evading clients' capital assets, then impose taxes of up to 48% on the subsequent income. This is an astonishingly large chunk to take out of these assets and income – yet there has been hardly a murmur of protest from Swiss bankers or their clients! Indeed, Swiss bankers have been declaring how 'fair' the deal is. British taxpayers are being reassured by Swiss bankers that their interests are being looked after. This is

[18] For instance, numbers are being floated, presumably in an effort to entice Greece into signing a deal, that there are 200 billion Euros of undeclared Greek assets in Swiss banks. This is inconceivable: it would mean that there are far more Greek taxpayer assets in Swiss banks than there are UK taxpayer assets, and the same amount of Greek assets as German assets. It also conflicts with earlier private estimates (p13 here) for undeclared Greek assets in Swiss banks - which come in at a figure of just CHF 24 billion, or 15 billion Euros.

not sufficient reassurance.

To conclude: UK Chancellor George Osborne's claim that " we will find you and your money. . . we will make sure that everyone pays their fair share" was delusional or deliberately deceptive.

It gets worse.

4.1.6. The knock-on effects on other tax havens make this worse

The Rubik deals have had powerful political effects, effectively sabotaging the European Union's moves towards greater transparency. What they have done, in effect, is to provide a powerful political route through which other tax havens can now refuse to join progress with the EU.[19] The volume of undeclared assets in other tax havens makes HMRC's numbers look even worse.

Take Luxembourg, for instance.

Luxembourg's private banking industry is estimated to hold €300 billion in assets under management (the majority of private banking undeclared), and a total of about €770 billion in assets and liabilities. Unlike Swiss banks, however, Luxembourg banks have relatively few offices around the world, and so the large majority of this will be European business (83% according to an analysis by HSBC Private Bank).

Assuming there is €500 billion in EU-resident undeclared funds in Luxembourg banks. (This compares to estimates ranging between €750 and €1,000 billion in undeclared EU money in Swiss banks.)

These UK and German deals with Switzerland, by politically sabotaging EU efforts to deliver better automatic information exchange, will cement Luxembourg's secrecy. Even if they *were to* secure the promised tax revenues – which they cannot - they would guarantee a similarly-sized loss of potential revenues from Luxembourg by providing the political avenue that allows it to resist automatic information exchange. The same applies to Liechtenstein, Austria and other tax havens that participate in the Savings Tax Directive, greatly magnifying the problem. For instance, the Telegraph newspaper recently contained the following quote:

> "Jersey is awaiting the outcome of EU negotiations with Luxembourg and Austria. Once these two countries scrap the withholding tax option, then Jersey is likely to follow suit."

In other words, Jersey will not follow suit until Luxembourg and Austria do. And Luxembourg and Austria are refusing to follow suit because of the Swiss deals.

In addition to all this, the agreement also increases market access for UK and Swiss banks in each country. This will undoubtedly expand the ability of Swiss banks to tout

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[19] For example, Luxembourg bankers argue that this deal introduces a discrimination and a distortion into the market. "If this model is not adopted within the EU, third countries that have negotiated bilateral agreements with individual EU Member States will be treated more favourably than EU Member States themselves.

for tax-evading business in the UK, and perhaps for British banks to bring their clients to Switzerland – undoubtedly furthering their growth and economic and political power to resist reforms.

In short, the deals will extract minimal tax revenues with one hand, while handing out far greater sums to criminals with the other, and bolstering the position of an already over-powerful banking sector.

All of this logically means that the Swiss deals will be revenue-negative for the UK in the medium and long term.

4.2 Objection 2: This was cooked up by Swiss bankers which is why it is a bad – and deceptive – deal.

This principle of the agreement was first created by the Swiss Bankers' Association in 2009. The original proposal, published in December 2009, stated, among other things, that:

> "Switzerland offers to collect the flat rate tax on income paid on balances of foreign- domiciled clients for countries that wish to avail themselves of the service. This tax is deducted by the paying agent (the bank) and credited to the tax authorities of the client's tax domicile.
> The flat rate tax means:
> • that the client's/tax subject's obligations to the tax authorities of his/her/its country of domicile are fulfilled. It is thus no longer necessary to report the client's/tax subject's assets and investment income to the tax authorities.
> • that the client's anonymity can be protected. The issue of automatic exchange of information thus becomes obsolete.
>
> With the flat rate tax model, clients still have the possibility of electing to have their assets reported instead of paying the flat rate tax, if they so wish."

(See a short summary of the document here.)

This, and many other elements discussed, reveal an original proposal that is extremely similar to the deal signed with the UK (and Germany). What is more, Swiss bankers explicitly (but privately) agree this. As one banker said:

> "The Rubik Project is originally a Swiss initiative. The Swiss have designed it as a way of appeasing other governments while (a) keeping full bank secrecy in place and (b) keeping their own access to important financial markets like London and Frankfurt unhindered."

From a marketing perspective, the SBA document promises to "build upon the Savings Tax Agreement" by plugging some of its loopholes: as Section 2.2 explains, these are the least important loopholes.

It is highly unfortunate that the UK and Germany have accepted an agreement essentially created by Swiss bankers, past masters at creating tax-evading, deceptive and criminal-friendly structures.

One of the concessions by the UK is on the subject of due diligence, a crucial element of any such agreement. The agreement states in Article 3.1 that:

> "In order to establish the identity and residence of relevant persons the Swiss paying agent shall keep a record of the name, first name, birth date, address and residence details in accordance with the prevailing Swiss due diligence obligations in place when establishing business relationships.

(and see also Article 2h in the agreement) for further confirmation of this.

Swiss due diligence is weaker than the amendments in the EU Savings Tax Directive, which relies on its money laundering and terrorist financing Directive (2005/60/EC.) See further details on Swiss due diligence in Section 3.1.

These glaring loopholes reveal how wrong the UK was to accept the Swiss model.

4.3 Objection 3: The deal may fall foul of UK law

The deal grants criminals who willingly submit to the deal – if there are any – immunity from prosecution. It is not a blanket immunity or amnesty, as this analysis outlines, but it provides a large degree of cover for criminals.

One element is the assertion that

> "The United Kingdom further states that the criminal prosecution of bank employees due to participation in tax offences is highly unlikely."

This is made worse by the assertion that:

> "the United Kingdom does not envisage to purchase stolen bank client data."

These restrictions effectively tie the hands of HMRC itself, the Crown Prosecution Service, and (in relation to tax evasion related offences in the banks, which come under money laundering laws - the Financial Services Authority and the Police.

So there is a good chance that the deal will not survive a legal challenge in the UK.

4.4 Objection 4: The deal is likely to fall foul of EU law

As mentioned, the tax deals between Switzerland, on the one hand, and the UK and Germany on the other, have wreaked havoc on European Union plans to create transparency through the amendments to the European Savings Tax Directive (see box 1).

Luxembourg and Austria have effectively brought the process to a standstill, arguing on September 22 that they refuse to be forced to switch from a withholding system to automatic information exchange between tax administrations, and thereby to abolish their banking secrecy, if Switzerland is not obliged to follow suit. Other tax havens such as Jersey seem to have taken a similar approach:

> "Jersey is awaiting the outcome of EU negotiations with Luxembourg and Austria. Once these two countries scrap the withholding tax option, then Jersey is likely to follow suit."

However, automatic information exchange is official EU policy, and that means that an official refusal to countenance automatic information exchange – a refusal that is explicitly linked to the existence of the UK-Swiss deals – creates a situation where these deals have implications that clearly contravene official EU policy. The EU is therefore likely to conclude that it can strike down the UK and German agreements, on this basis.

The EU Committee on Economic and Monetary Affairs has already submitted questions as to whether this agreement fits into the proclaimed EU aim for stronger tax cooperation between EU members states, and to what extent it represents an obstacle to this. It also asks whether the UK and Germany (and others) actually have the competence to negotiate such bilateral deals, and whether the EU was consulted on these negotiations (apparently, it was not.)

The question was also asked as to whether this deal is compatible with the agreement between the European Commission and Switzerland providing for 'measures equivalent to' the EU Savings Tax Directive. Section 4.4.1 explores this last question. Hinting at legal problems to come, Swissinfo reported:

> Before Swiss bankers can breathe a collective sigh of relief that their cherished secrecy has been saved, the European Union warned that the proposed deals with Germany and Britain would not be allowed to supercede EU demands for an automatic exchange of tax information."We have assurances from Germany and the United Kingdom that they are totally behind our aim of achieving automatic exchange of information within the EU, and of promoting as broad a system of information exchange as possible at an international level," said Emer Traynor, spokeswoman for the EU commissioner for taxation, Algirdas Semeta."If there is a conflict, European law always takes precedence over bilateral agreements," she added.

4.4.1 Not remotely equivalent to automatic information exchange.

In this context, the UK, German and Swiss governments are arguing that the agreement has:

> "a long-term impact that is equivalent to the automatic exchange of information in the area of capital income."

The argument is made that even though secrecy is preserved, tax revenues from the deal will be equivalent to the tax revenue that would be obtained under automatic information exchange.

This is important because EU law holds that automatic information exchange is the required standard.

However, this document, outlining some of the major loopholes and escape routes and knock-on effects, demonstrates that this will be revenue-negative for the UK. What is more, its effect on undermining the rule of law is incalculable.

For these reasons, this is absolutely not equivalent to automatic information exchange.

4.5 Objection 5: The '500 requests per year' is a smokescreen

The UK-Swiss agreement allows for the possibility of the UK making up to 500 requests per year, on quite a broad basis. HMRC head Dave Hartnett added:

> "There's a novelty with this provision as well, and that is that the more successful HMRC is in identifying people who have additional tax liability to pay, the greater the number of people we will be able to search for. The 500 raises like a ratchet. And if we are hopeless at identifying people who have hidden the money the 500 will come down."

This is being billed as a major victory for transparency. It is an improvement on current information exchange agreement. However, closer examination raises many questions.

Freedom of Information requests by the British publication Private Eye reveal that the UK made an average of less than 2.5 information requests per year to Switzerland between 2004 and 2010, and the Swiss government made precisely zero spontaneous provisions of information to the UK. It is hard to believe that the expanded scope of information-sharing under the UK-Swiss deal, while welcome in itself, will produce a two-hundredfold increase in the number of requests.

The far, far better approach is automatic information exchange.

4.6 Objection 6: Will the Swiss tell the UK where the money has gone?

In addition to this, Article 18 of the agreement notes that the Swiss government will reveal to the UK government the top 10 jurisdictions to which the relevant persons have moved their assets. This is being paraded as a useful tool to help the UK to know where to look next. But this is laughable and near-worthless.

First, TJN, or any newspaper reader, could probably give the UK a fairly good idea already. Singapore, Hong Kong, the Bahamas and Panama are likely spots. Further clues can be found here.

Second, if the mechanisms used are discretionary trusts and their like – as many if not most probably will – then the Swiss will not class them as relevant assets and they will not be identified.

Third, the section (Article 18) which deals with this notes:

> "The report shall also include the number of relevant persons concerned for each State or jurisdiction. **The Contracting States shall not make public the data collected and reported based on this Article.**"

That second part is designed in part to make this information invulnerable to Freedom-of-information requests. This is absolutely unacceptable: the deliberate loopholes in this agreement reveal a government that cannot be trusted to act in the service of UK (and other) taxpayers; and this blanket of secrecy makes matters worse.

Fourth, plenty of the money will move from Switzerland to a second or third country, or at least to a new offshore structure based in another secrecy jurisdiction.

Fourth, and fatally, in many cases it does not matter so much where the assets have moved to: what matters more is where the structures – such as trusts and foundations – that own the assets are located. This is not explicitly provided for in the agreement.

5. A BETTER WAY TO PROCEED

There are alternative and far more effective ways for the two countries to tackle their criminal tax evaders and obtain tax revenues.

A first step would be to scrap these deals and take the United States' far more robust approach to criminal tax evasion. Their highly successful strategy has been to target one bank and relevant bankers, put some in jail if necessary or otherwise under pressure, bargain with them to obtain more information, pursue further investigations, spread the net wider to cover more banks, and so on. Currently, eight offshore banks are under Federal Grand Jury investigations, possibly with more to follow.

This approach has the potential to gather major tax revenues in its own right, and it is an approach far more consistent with the application of justice. Not only that, but it puts the United States in a far, far stronger position when it comes to negotiating a tax deal with Switzerland.

A second approach, entirely compatible with the first, would be for the UK to scrap this deal and throw its full support behind current European efforts to deliver financial transparency and tax compliance through the European Savings Tax Directive. The directive is currently full of holes, like the UK-Swiss deal, but is in the process of being amended to seriously beef it up.

5.1 The EU Savings Tax Directive amendments

As *Box 1* above explains, the EU Savings Tax Directive is an arrangement where participating members agree to share information with each other about interest payments received by each others' citizens (or, for a transitional period, apply an anonymous withholding tax). It is full of loopholes, but is in the process of being amended with a whole array of powerful techniques, some wielded in the international tax arena for the first time in history.

Whereas the Rubik deals only cover 'relevant assets,' the EU Savings Tax Directive covers income from whatever source. What is more, it gets around the beneficial owner problems with innovative mechanisms.

When the amendments come into force, quite possibly next year for implementation

in 2015, the EU Savings Tax Directive will be a very different proposition, with real teeth. Here, in essence, is how the amendments will plug the loopholes.

5.1.1 Tackling Escape Route 1: foundations, discretionary trusts etc.

Tax advisers have asserted that if discretionary trusts and foundations have no immediate identifiable beneficiary, then they cannot be taxed.

The EU amendments prove them wrong, dealing with such entities and arrangements in a wholly new way using specially developed concepts that have never before been deployed in the field of international tax. The concept is known as "Paying Agent Upon Receipt'" in the EU jargon.

Box 4: The EU amendments and Paying Agent Upon Receipt

This is probably the most important new concept in the EU Savings Tax Amendments. It enables structures such as discretionary trusts and foundations, previously considered 'untaxable' by many tax advisers, to be brought into the tax net for the first time.

Here is how it works. First, the amendments move responsibility for applying the Directive's provisions away from banks and instead gives this responsibility to the management of the fiduciary structures (foundations, trusts etc.) This is crucial: with a structure like a trust or a foundation, it is often only the management of the structure – the trustees, the foundation council, or the directors of anstalts or international business companies – who really know the true identifiable beneficiaries. The managements are the only ones with access to the 'letter of wishes,' those special 'instructions' about how the structure is to be managed. The bank that holds its accounts in some cases may have no idea what the structure is really all about.

The EU deems these structures to be *Paying Agent Upon Receipt* and identifies them as follows:

> "An entity or a legal arrangement which has its place of effective management within a Member State and which is not subject to effective taxation under the general rules for direct taxation applicable either in that Member State, or in the Member State where it is established, or in any country or jurisdiction where it is otherwise resident for tax purposes, shall be considered to be a *paying agent upon receipt* of an interest payment or upon securing of such payment."

In other words, if the management of such a structure is somewhere in the 42 EU Savings Tax territories, then it must apply the provisions, *wherever in the world* the bank accounts are held, be it Liechtenstein, Singapore or Nauru. So if a New Zealand trust with a bank account in Hong Kong is managed by a trustee based in London, the trustee will have to implement the Directive's provisions.

The management must then do a three-step process to identify a beneficial owner on whom to apply the savings tax.

First, they try to establish the individual immediately entitled to the assets or income.

Second, if the individual cannot be identified, then the beneficial owner is *deemed* to be the person who directly or indirectly contributed the assets to the structure – whether or not they are entitled to the assets, or gave the assets away irrevocably.

Third, if for some reason the contributor is not identifiable – perhaps they have died, or they are somehow hidden – then the manager of the structure must track the income earned for ten years and apply the tax when an individual becomes entitled to the payment. (In the EU jargon, the management is then called the "*Paying Agent Upon Distribution*.")

These radical and powerful steps by the EU will bring these slippery structures into the tax net.

In summary, the management of the structure is responsible for applying the directive, and it applies the tax provisions either as the money comes in to the structure, or, failing that, as it comes out the other end later.

(Click here for a more detailed explanation of the Paying Agent Upon Receipt idea.)

The UK-Swiss deal completely fails to incorporate these ideas. What is more, the EU system works particularly well because it is multilateral one covering 42 jurisdictions, which is makes it far harder to escape. (Even if the UK-Swiss deal had incorporated this concept, as a bilateral agreement it would have only a fraction of its potency.)

5.1.2 Tackling Loophole 2: insurance wrapper.

Any Life insurance policies issued after June 2010 is in the deal's scope if the payouts:-
a) provides a guaranteed income, such as a short term annuity, or
b) the actual performance contains at least 25% interest.. The savings tax is ultra strict against insurance policies as the entire benefit (excess of payout over premiums paid) is regarded as an interest payment.

The relevant amendment is 6.1 e) on page 23-4 of this document; further explanations).

5.1.3 Tackling loophole 3: commercial, manufacturing companies etc.

Loophole 3 in the UK-Swiss deal is where a company falls outside the scope of the arrangement if it supposedly has a 'commercial' purpose such as 'trading' or 'manufacturing.' Offshore companies that would suit this arrangement can sometimes be set up for a few hundred pounds.

The EU savings tax amendments cut through all these subterfuges by bringing into scope any entity or arrangement, no matter its purpose, if it is "**not subject to effective taxation**" (Article 4/2.) This is a massively expanded scope.

5.1.4 Tackling Loophole 4: branches in Singapore etc.

It is not easy to tackle the shifting of assets to branches in Singapore or elsewhere. However, the *Paying Agent Upon Receipt* concept (Section 5.1.1 above), goes a long way to incorporating money shifted to branches of Swiss banks in places like Singapore, or subsidiaries in the Bahamas.

The EU amendments cover the *management* of the structures – the trustees and foundation councils and so on – that hold the assets, wherever the assets are held. They only way to avoid this will be to move the entire structure, lock, stock and barrel – including its entire management - to that other jurisdiction. Some criminals will do this, but many won't: people usually like to deal with familiar trustees nearby when managing their money, especially when managing their financial fortunes. Furthermore, money laundering tools can be brought to bear in such cases where the structure is managed outside the EU's scope: see more details in Section 5.1.5, below.

In addition, for similar reasons of familiarity and trust, customers will generally stay with Swiss banks even when moving their assets to Switzerland. As Reuters puts it, quoting senior Swiss banker Louay Al-Doory, talking about clients shifting their money to Singapore.

> "It would be moving from Swiss bank 'A' to Swiss bank 'B' in Singapore. What you will not find is local banks taking any of this money," Al-Doory said.

Even though the EU amendments on exchange of information do not explicitly cover branches of banks, logically it is only a matter of time before these obligations are extended to cover non-EU branches. The Swiss-UK agreement, by contrast, leaves them permanently exempt. (And even if it did, it would be massively weaker, by virtue of being a bilateral agreement covering two countries, whereas the EU scheme covers 42 jurisdictions.)

The UK already has experience of mandating banks with head offices in the UK to exchange information on branches in the Crown Dependencies; it is inexplicable why it did not insist on a similar provision to be inserted into the UK tax deal.

5.1.5 Tackling escape route 5: Categories of income

The UK-Swiss deal includes dividends and capital gains, but excludes other forms of non-capital income such as directors' fees, loans, etc.

The EU Savings Tax Directive amendments do not directly cover dividends and capital gains. However, it addresses them indirectly.

Applying automatic information exchange to the interest income would reveal the existence of the account – giving the UK and other countries a clear marker enabling them to request full information on the entire account including all the capital assets, thus providing a road map towards ascertaining capital gains and dividends.

A new EU Directive on administrative cooperation in the field of tax (overlapping with, but separate from the EU Savings Tax Directive) will further beef up the provisions. The Directive, 2011/16/EU, will introduce automatic information exchange from 2015 on five categories of income that are not in the UK-Swiss deal: income from employment, director's fees, life insurance products not covered by other Directives, pensions, and ownership of and income from immovable property. Pressure should be exerted on Switzerland to adopt this Directive.

5.1.6 Tackling Loophole 6: Swiss trustees of foreign trusts

When a Swiss trustee manages a trust with a bank account in Singapore, this falls outside the scope of the UK-Swiss deal.

However, under the EU amendments the Swiss trustee would be classed as a *Paying Agent Upon Receipt* (see Section 5.1.1 above) so would be tackled. If the structure is managed within any one of the 42 jurisdictions where the EU Directive is effectively applicable, then it is covered by the amendments even if it has an account outside these territories. This is a massively expanded scope.

6. Talking points

6.1 The effrontery of those selling these deals is galling

Swiss bankers know very well that this agreement has loopholes. Presumably some Swiss politicians have an inkling, or they have been badly briefed. It is particularly galling to see articles with headlines such as Switzerland portrayed as EU's saviour containing elements such as this:

> Calmy-Rey also noted that Switzerland played a role in the stabilisation of the economic situation in Europe, through the International Monetary Fund and the Swiss National Bank. And this role could grow, thanks to "Rubik", the name given to the bilateral tax agreements concluded in August by Switzerland with Germany and Britain.
>
> "European parliamentarians began to look towards Switzerland as part of the solution [to this crisis] as soon a withholding tax [taken by Swiss banks from the income made on capital in non-resident accounts] made it possible to transfer some money to countries in difficulty. Not as part of the problem."
>
> In short, Switzerland could quickly meet the demands of beleaguered Greece. . . Exploratory discussions are already under way with Athens.

Greece is indeed 'beleaguered' – plagued by (among other things) rampant tax evasion facilitated by Switzerland. Deals that will allow this to continue should not be

dressed up as efforts to ‘help’ Greece.

6.2 This is a Source of shame for the British accountancy profession

It is staggering that the British accountancy profession seems to have been almost unanimous in its silence over these loopholes – even after they had been directly pointed out to them, such as through Nicholas Shaxson’s Guardian article. A UK-based seasoned observer, contacted by email to ask about this wall of silence replied as follows:

> “The beancounters naturally position themselves where it's most profitable. The big ones are very close to Hartnett and the Treasury and won't get into their bad books. They and the smaller ones also look at any initiative as a fee-generator. So they say "whoa, taxman's on the warpath", better get some advice quick. It's a big game - like the image Hartnett cultivates as the sharp shooting tax sheriff - that suits them all.

The UK media, even in the field of accountancy, but with some exceptions, also should carry some blame in the sense that it has generally published the official line about these (admittedly highly complex) deals, repeating official assurances that this “will” raise £4-7 billion revenue, without raising appropriate questions.

6.3 Consider the American model, and support Europe in its time of need

The UK should follow the U.S.’ approach of eschewing sweetheart deals like this and instead going directly after banks and bankers, putting pressure, extracting further information about other banks, spreading the net and generally applying pressure. This would, among other things, put the UK in a position of real strength when negotiating tax deals with Switzerland. Instead, the UK has chosen to negotiate from a position of weakness. It is hard to understand why.

When the UK deal was initialed recently, the French newspaper La Tribune wrote an article under the headline “London sells its fiscal soul for six billion Euros.” In reality, the UK will be selling its soul for just a tiny fraction of that.

As a tax adviser put it: “Britain and Germany will destroy so much – for tuppence.”

END