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SWISS DOUBLE TAX AGREEMENTS: THE DEVELOPMENT PERSPECTIVE

Switzerland has relaxed its banking secrecy. Since March 2009 it has negotiated two dozen new double tax agreements that include the exchange of information for tax purposes in accordance with Article 26 of the OECD Model Tax Convention. Yet developing countries are still excluded from information exchange on request.

Sind wir Schweizer alle Verbrecher? Are we Swiss all criminals? This advertising campaign on the subject of banking secrecy reflects a sense of unease among many Swiss about what their banks are doing (Photograph: Nick Shaxson)

Introduction

Developing countries lose billions annually in government revenue through the flight of assets to Switzerland and resulting lost taxes – money they urgently need for reducing poverty. But very few Southern governments have so far sought new Double Tax Agreements (DTAs) with Switzerland that foresee the exchange of information about tax evaders.

The reason for their reluctance is that DTAs not only regulate tax information exchange, but also affect a key element of bilateral economic relations: the taxation of foreign investment. Switzerland is now pressing for lower withholding taxes on dividends, interest and royalties paid to Swiss investors, in return for introducing tax information exchange on request. For developing countries, taxing earnings on foreign inward investments may be just as important as combating international tax evasion by wealthy locals.

Information exchange with OECD states only

Since the OECD blacklisted Switzerland as a tax haven in March 2009, the Swiss government has negotiated new international double tax agreements with over two dozen countries (the OECD has made the signature of information exchange agreements under OECD standards the condition of getting off its blacklists.) Those agreements now include tax information exchange as per Article 26 of the OECD model tax convention – the article that deals with information exchange. Yet the agreements already signed are, with few exceptions,[1] only with industrialised countries. And a referendum may yet be held in Switzerland against the agreements ratified by Parliament.

[1] The exceptions are Kazakhstan, the oil state of Qatar, and the two emerging market countries Mexico and India. A new agreement has also been negotiated but not yet signed and published with Uruguay.

Table 1: Admissible withholding tax rates – DTAs with and without OECD Article 26

	Dividends			Royalties
	Maximum rate	**Maximum rate in the case of so-called "qualifying holdings"**	**Minimum capital share to qualify as "qualifying holdings"**	
Average values DTAs without OECD26 (before March 2009)				
Low-income countries	15.0	13.3	22.5	7.6
Middle-income countries	14.5	6.7	21.1	7.2
High-income countries	13.5	5.6	20.2	3.4
Average all countries	*14.1*	*6.6*	*20.8*	*5.6*
Average values DTAs with OECD26 (after March 2009)				
Low-income countries	…	…	…	…
Middle-income countries (Mexico)	15	0	10	10
High-income countries	13.1	2.7	11.5	1.5
Average all countries	13.2	2.5	11.4	2.1

Source: Own calculations based on Federal Tax Administration data; as at 20 July 2010

The poorest developing states are entirely absent from the list of those with which Switzerland has concluded new double tax agreements that provide for information exchange on request. In June this year Switzerland signed new DTAs with the two Swiss development aid recipients Tajikistan and Georgia, notably containing *no* OECD-type information exchange – in diametric opposition to the imperative of policy coherence for development.

The Swiss government, of course, rejects the charge that its tax policy is systematically harming developing countries. Yet its report published last December on the future financial centre strategy made it clear that with regard to new DTAs, "negotiations with OECD member states have priority" (author's translation). The government's negotiating strategy thus reacts mainly to political pressure from powerful industrial countries. Weaker developing countries must either wait, or accept DTAs with no information sharing provisions.

Information exchange against tax cuts

Developing countries have put little diplomatic pressure on Switzerland to sign new OECD-type double taxation agreements quickly. This does not mean they are not interested in better information sharing. Their caution stems from the complexity of DTAs, which are less about administrative assistance against tax evaders than about taxing foreign investments – a central issue in bilateral economic relations. Over 70 developing countries have never signed a DTA with Switzerland, because the negotiations would simply be too costly.

Developing countries with pre-existing DTAs also now risk seeing lower maximum tax rates on Swiss foreign companies. In its DTA revisions done since March 2009,

"Developing countries wanting new OECD- type double tax agreements with Switzerland risk being forced into tax concessions"

"The most effective weapon against international tax evasion would be automatic information exchange. Switzerland must urgently give up its obstructionist approach."

Switzerland has insisted on steep cuts in withholding taxes on dividends, interest and royalties paid to the other countries. Table I shows that the newly negotiated agreements contain distinctly lower tax ceilings than the previous ones, in particular on dividends from qualifying foreign holdings and on royalties. Most of the new agreements even stipulate a zero tax rate on dividends from qualifying holdings.

Switzerland is thus exacting a high price for giving countries future access to information on tax evaders. Rather than introducing automatic information exchange, Switzerland expects partner countries largely to waive taxes on earnings from Swiss foreign investments in exchange for the relatively ineffective OECD standard.

Special provisions for developing countries?

Until it adjusted its financial centre strategy in March 2009, Switzerland's DTA policy stood out in that it gave developing countries greater scope than middle and low-income countries to levy withholding taxes (see Table I) following the UN model agreement. But the government has made no binding statement on continuing this preferential treatment of developing countries in future.

In this context, the revised DTA with emerging country Mexico sends a disturbing signal. Switzerland has imposed a zero-rate tax on dividends from significant capital holdings, down from a five per cent tax ceiling. So Mexico, having already unilaterally eliminated taxes on dividends, has now lost the possibility to reintroduce such a tax. In Switzerland's new DTA with Georgia the zero rate was agreed not only for dividends from substantial capital holdings, but also for interest and royalties – even though the agreement foresees no tax information exchange. So Georgia will neither get support from Switzerland in combating international tax evasion, nor can it tax earnings on Swiss investments. At the same time the country will continue to receive Swiss development funds.

What should be done?

Developing countries wanting new OECD-type double tax agreements with Switzerland risk being forced into tax concessions on Swiss foreign investments, in exchange for information sharing on tax evaders. But Switzerland's parameters for administrative assistance requests from abroad are so restrictively formulated that information exchange is highly ineffective, and to get information out of Switzerland, foreign authorities must already possess their names and details on the relevant Swiss bank account.

Meanwhile, the Swiss government intends to enact internal regulations soon whereby requests for administrative assistance will not be pursued if based on "stolen" bank information. This is contrary to OECD standards and disregards a legal opinion from the Federal Office of Justice to the effect that such a provision must figure not in a national ordinance, but in every DTA.

A developmentally meaningful alternative to DTAs with expanded administrative assistance would be to offer developing countries a simple tax information exchange agreement (TIEA). In it, the conditions for mutual assistance between tax authorities should be aligned with the administrative capacity of these countries and be designed to be as low-threshold as possible. The issues of double taxation of foreign investment should be addressed separately.

But the most effective weapon against international tax evasion would be automatic information exchange. Switzerland must urgently give up its obstructionist approach.

At the same time, Switzerland should extend its existing savings tax agreement[2] with the EU to developing countries. At the 2008 UN conference in Doha it already announced its readiness to examine requests by developing countries to set up a withholding tax on savings interests paid to their citizens. It has not actively pursued this proposal since then, however. So it is up to governments and civil society organisations in developing countries to hold the Swiss Government to its word.

Mark Herkenrath,
Alliance Sud

[2] Under the EU Savings Tax Directive, EU member states supply information automatically about each others' taxpayers. Switzerland does not participate in this directive, but has agreed in a separate treaty with the EU to collect a witholding tax on savings interests.

BANK SECRECY: SWITZERLAND CIRCLES THE WAGONS

editorial

Bruno Gurtner

Only intense external pressure has persuaded Switzerland to adopt international standards in its foreign tax policy. Despite having made verbal concessions, however, it continues its resistance.

At the European Court of Justice in Luxembourg in early September, Switzerland lost a dispute with its northern neighbour Germany over aircraft flight noise. A newspaper commentator remarked bitterly that Switzerland is being defeated disturbingly often in this aerial conflict, because it is misjudging its own position relative to other countries.

Similarly, when it comes to financial markets, banks, secrecy and tax, Switzerland chooses to observe global signals only partially or not at all. Former Swiss Finance Minister (and current UBS President) Kaspar Villiger has repeatedly said that banking secrecy is not negotiable. Finance Minster Hans-Rudolf Merz, who will step down at the end of October, said in early 2009 -- to the applause of the financial sector – that "they will break their teeth on banking secrecy."

The Federal Council, Switzerland's government, and its financial sector appeared until quite recently to be immune to all criticism from abroad, and wanted to resist all pressure. As former Social Democratic parliamentarian Rudolf H. Strahm puts it, Switzerland has maintained a "circle the wagons" mentality: give up ground only bit by bit, if at all. For a long time, OECD efforts to improve cross-border information exchange between banks and tax authorities was disdainfully rebuffed, and when the OECD tried to identify and abolish harmful tax practices it was rubbished in Switzerland, and given the contemptuous label "tax cartel."

Recently, however, the country has had to make bigger concessions. Its position was noticeably weakened when U.S. Authorities discovered in 2008 that UBS had been involved in criminal activities in the United States. A threat by the G20 in 2009 to place Switzerland on a (grey-) or blacklist, and the fear of possible sanctions, forced it to loosen banking secrecy; the government has promised to recognise the OECD's "on request" standard for cross-border exchange of information – albeit an exceedingly weak form of information exchange.

The uniquely Swiss distinction between tax fraud (forgery of documents) and simple tax evasion (documents omitted or "forgotten") – a technical and ideological distinction that has helped the Swiss authorities ensure they receive information on salaries and wealth, while allowing capital income to remain hidden -- no longer remains, at least for dealings with foreign clients – though the distinction still exists domestically. Switzerland also promises quickly to modify existing double tax agreements and future agreements will follow the OECD standard. More than two dozen agreements have been negotiated or concluded.

The recent episode confirms a pattern in Swiss history suggesting that the most effective way to apply pressure on Swiss secrecy is when it is exerted on its banks, rather than on the jurisdiction itself: the latter approach can be counter-productive, and lead to national feelings of victimisation and defensiveness.

The kerfuffle over Swiss banking secrecy in 2008 and 2009 is settling down again now, and Switzerland is circling its wagons again, having retreated to a new defensive position. When Merz speculated in February 2010 that automatic information exchange (a far more transparent system) might be considered, local opposition was swift and fierce: automatic information exchange would be categorically rejected. Even exchanging of information "on request" is not granted unconditionally: the Finance Ministry has formulated eight tough conditions which have been approved by the government and are waiting to be ratified by parliament. Among other things, the requesting country must identify the tax-avoiding person beyond any doubt, supply the account number, and explain why it believes that the Swiss bank has relevant information. In other words, a foreign country must already know what information it wants before it makes a request! Finally, Switzerland will not provide any information if the submitted request is based on "stolen" data obtained by whistleblowers.

The Swiss are proud of their own traditions, and pressure from outside the country is often widely resented (Photograph: Nick Shaxson)

Another example illustrates the Swiss government's and financial sector's dishonest stance. The Financial Action Task Force

"This is what Andreas Missbach of the Berne Declaration calls Switzerland's Zebra strategy: white money for neighbouring or powerful countries, and black money for developing countries."

(FATF) seems likely to take a major step soon by qualifying tax evasion as a predicate offense for money laundering, thus strengthening the reporting requirements for banks and financial intermediaries. Behind the scenes, Switzerland is putting up fierce resistance, seeking to limit the scope of the FATF's definition of tax evasion so that only very major tax crimes would be classed as predicate offences for money laundering purposes. With such antics, the Swiss government and financial sector are undermining their own explicit promise to want no more untaxed money in the Swiss financial center.

Switzerland has only half-heartedly joined international efforts to tackle international tax evasion. In November 2008 Swiss Foreign Minister Micheline Calmy-Rey unexpectedly proposed that Switzerland could tax assets originating from developing countries in Swiss bank accounts – provided that other countries also take part – and return the proceeds to those countries. Nothing came of the idea. Switzerland has already agreed to exactly this mechanism via its Savings Tax Agreement with the E.U. – but it seems curiously unwilling to extend this principle to developing countries. This is what Andreas Missbach of the Berne Declaration calls Switzerland's Zebra strategy: "white" money for neighbouring or powerful countries, and black money for developing countries. Switzerland's private banks are rapidly increasing their activities in Asia in particular.

The State Secretariat for Economic Affairs (SECO) supports the international Extractive Industry Transparency Initiative, but on the other hand the government has tersely rejected country-by-country reporting for multinational corporations, considering "the existing rules as a sufficient basis for a transparent relationship between tax authorities and taxpayers." The majority of a parliamentary advisory commission rejected proposals for an upcoming revision of domestic accounting laws that would oblige Swiss firms with international operations to include detailed country-by-country information in their annual financial statements (though this proposal will now be introduced as a minority motion in Parliament.)

This edition of Tax Justice Focus deals with several questions that are currently being discussed in Switzerland. Readers will find contributions from three Swiss-based external specialists, and three active Swiss-based members of the Tax Justice Network.

Mark Herkenrath from AllianceSud shows that nothing has changed in Swiss foreign tax policy for tax evaders in developing countries. Those countries that want the OECD standard for information exchange must be prepared to make drastic tax concessions to Switzerland in other areas.

Peter Hablützel, an author who served directly under several finance ministers, illustrates how the financial sector grew powerful and exploited the state for its own interests.

Daniel Thelesklaf, a specialist on the subject of money laundering, shows how Switzerland has some things to be proud of, but is by no means the model country that it often portrays itself to be.

Prof. Thomas Cottier from the University of Berne illuminates the tax dispute between Switzerland and the E.U. over the taxation of companies. His simple proposal is that Switzerland accepts the provisions of the E.U. Code of Conduct for corporate taxation as a basis for its own corporate taxation.

Olivier Longchamp of the Berne Declaration acknowledges that Switzerland has taken significant steps in the repatriation of dictators' assets, and the parliamant just adopted a special law on the restitution of illegal assets. But here, too, Switzerland has acted only half-heartedly.

Finally, **Andreas Missbach,** also from the Berne Declaration, tracks the UBS scandal and its implications, and makes clear how Switzerland is entrenching itself behind new lines of defense.

In this edition, readers will also find a review of *Tax Havens: How Globalization Really Works* co-authored by Ronen Palan, Richard Murphy and Christian Chavagneux, a report on our transfer pricing project; on the Yaoundé Declaration, and a look at the schedule for the UN Tax Committee's October meeting.

Hans-Rudolf Merz: "they will break their teeth on banking secrecy."

On the subject of Switzerland, we could have highlighted any number of other problems. One possibility would have been to examine global commodity trading firms who have chosen to base themselves here; another would have been to explore Switzerland's efforts to be a "five-star establishment" for foreign enterprises, leading to more and more corporations – including dubious ones –locating their headquarters here. Or we could have detailed the rising domestic criticism against special tax privileges granted to rich foreigners, notably to tax them not based on what they actually earn, but according to their living costs. Alternatively, we could have explained how inter-cantonal tax competition leads to exceedingly large differences in tax burdens within Switzerland.

For us it's clear: We are not going to run out of work any time soon.

Bruno Gurtner, Chair of the Global Board of Directors, Tax Justice Network

THE BANKS AND THEIR SWITZERLAND

feature

Peter Hablützel

The financial crisis has shaken Switzerland's image and its self-confidence. Risky casino-type gambling by the biggest Swiss banks has burdened the state and the taxpayer, and criminal behaviour by UBS in the United States compelled the Swiss authorities to relax Switzerland's hitherto jealously guarded banking secrecy. A national myth that Swiss bank secrecy is inviolable has been destroyed, and it is becoming increasingly obvious that the major banks have been capturing state and government policies.

Switzerland's political system is known for its striking peculiarities, but it has never in itself had much weight. In theory it purports to be liberal, but in practice, concrete economic interests ultimately prevail. Special interests have always dominated regulatory policy in this country.

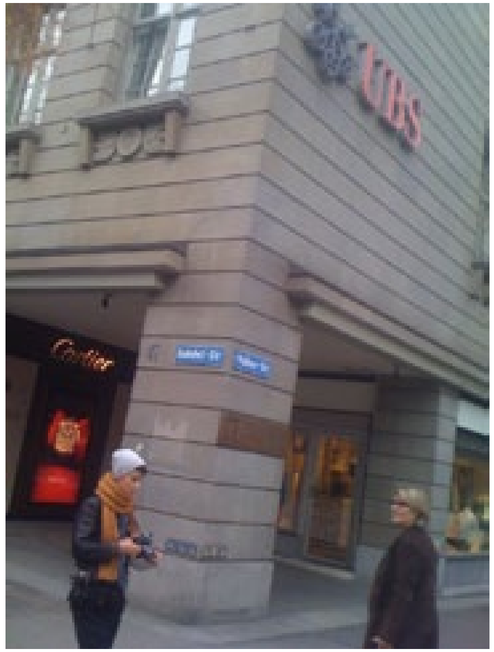
The flourishing financial sector is, as it were, the physical embodiment of the Swiss identity. Few other countries have such a relatively large financial sector and are globally as highly invested as Switzerland. At the onset of the crisis, the two major Swiss banks UBS and Credit Suisse (CS) held almost 90 per cent of the balance sheet total of all banks in Switzerland, which was eight times GDP. By comparison, the balance sheet total of all American banks together is roughly the same size as U.S. GDP. Switzerland's unusual status stems largely from the dependence of the country and its political life on a globally oriented economy.

The openness of the Swiss economy is a geographical necessity, based on centuries of experience. Little Switzerland always made big money in its international dealings. Yet the rise of the Swiss financial sector to international significance is relatively new in historical terms. It was only in the late 1960s that spectacular, often double-digit growth began, thanks mainly to the expansion of international business, the prime beneficiaries of which were the banks. Social and political stability, and a strong Franc, made Switzerland a safe haven for capital. Strict banking secrecy also attracted untaxed and criminal funds.

"The financial crisis is now disabusing our financial sector of its fantasies of omnipotence, and unmasking our political system."

After numerous scandals, the national mood became decidedly critical of the banks in late 1970s. Yet by dint of propaganda campaigns costing millions, the financial sector rehabilitated its image. The clear rejection in a 1984 referendum of a banking initiative designed to combat tax evasion and the hoarding of flight capital was emblematic of the growing influence of banks on public opinion and politics in Switzerland.

The major banks based their economic success on the interlinking of retail and commercial banking. Cheap funds from the public financed the rapid rise of export industries and the modernisation of Switzerland's economy. From their substantial profits, the major banks sponsored sport, art, culture and politics. In 2007, for example, a respected Zurich senator received 100,000 Swiss francs from a major bank for two meetings per year. UBS was still making contributions to centre-right parties even after they had received state subsidies. The centre-right-dominated parliament threw out a motion to waive such contributions even temporarily. The amount of the contributions is still unknown.



Bahnhofstrasse: the luxury Zurich street that houses many of the world's banking secrets. (Photograph: Nick Shaxson)

Along with Swissair, the banks were Switzerland's flagship companies and its most progressive employers. They exerted strong social influence through a militia system in politics and the military in which the economy, the political system and the army were dominated by the same elite.

Until the 1980s, the financial sector remained geared towards the interests of Swiss industry, funding its investments and exports, *"The major banks abandoned their previous role as pillars of national industry and began to pursue speculative profits in the global marketplace, according to its rules. "*

optimising its costs and underwriting its risks. In the early 1990s a real estate bubble burst, causing a banking crisis and over 50 billion francs in losses. The legacy from the bank failures passed to many small banks, which were taken over by the big banks, which were able to offset their own losses with growing profits from international business. At the same time, consolidation amongst the five surviving big banks left UBS and CS fully dominant in the Swiss market, and as universal banks competitive on the world market.

The push towards globalisation in the Swiss financial sector – which also involved a shifting mindset – only occurred in the 1990s, in parallel with the concentration process. It was a turbulent time of economic restructuring. The strong Franc increased Swiss overseas investments, leading to a rapid de-industrialisation of Switzerland and claiming large, venerable corporations like Sulzer as casualties. The major banks abandoned their previous role as pillars of national industry and began to pursue speculative profits in the global marketplace, according to its rules. The financial sector has grown increasingly specialised and with its now virtually opaque products has become the *financial industry*: what was once a "service" sector in the economy and society now sees itself as a producing sector. The question as to what constitutes genuine value-added in this sector – as opposed to "value extracted" – remains open.

In any case, financial transactions on the banks' own account soon began to yield much greater profits than financing transactions on behalf of others. Client funds increasingly became the lever with which to garner enormous speculative profits, using little of the banks' own funding. The banks' traditional businesses of amassing relatively cheap and short-term savings to create longer-term investable capital, as well as portfolio management and other traditional banking activities, have continued to flourish. But their importance and prestige have declined in favour of investment banking, which promised substantially higher profits through IPOs, mergers and restructurings, as well as speculation on the banks' own account.

Spoiled by success, many bankers felt themselves to be "masters of the universe" and developed an arrogance, increasingly reflected in exorbitant salaries and bonuses. The clearest indication of the change of culture was in the way the financial elite related to political leaders and the military. Since the 1990s bankers have radically disconnected themselves from national involvement (political parties, officer corps, etc.) and have become highly Americanised. A certain contempt was even perceptible towards political circles. By handing down white papers and other instructions to politicians, the bankers made their neo-liberal plans known, without seriously engaging in dialogue.

Globalisation has drastically curtailed the state's ability to influence the economy, and national economic policies have found themselves increasingly at the mercy of mobile capital. These issues have come to affect banking supervision. The authorities have long refused to acknowledge that a small economy with very big banks faced special risks, and the Banking Commission, the Swiss financial market supervisory authority, has favoured the short-term interests of the financial sector. Generously interpreting the Basel Recommendations -- and despite massive objections from the Swiss National Bank -- it gave its blessing in 2004 to new UBS risk models and calculations, enabling the banking giant to incur even greater debt for its risky dealings on American capital markets. With a capital ratio of less than two per cent – the lowest worldwide – UBS fell into crisis.

The financial crisis is now disabusing our financial sector of its fantasies of omnipotence, and unmasking our political system. It is demonstrating the authorities' servile attitudes towards major economic interests, and the system as a whole has lost credibility. It could even be said that the crisis has ripped the liberal mask away from the face of Switzerland.

In this respect, two events will long be remembered. In October 2008, the Swiss Confederation and National Bank had to support UBS with a massive financial injection, which was at the brink of collapse. Then, in February 2009, the authorities themselves violated Swiss law in order to free this financial flagship from the US justice system, after it was found to have wilfully violated U.S. laws. The two events are of great symbolic importance and raise the critical question of just how much meaning still attaches to liberal regulatory policy and legal certainty in our country, when the business interests of a large private bank are at stake.

Can Switzerland itself find the strength to break free from the grip of the big banks? I doubt it. But perhaps the increasing politicisation of the world economy will help us tackle the the enormous size of our major banks and the "concentration risk" to our economy, which risks state and society being called on to bankroll the errors and excesses of private managements.

Political leaders cannot be content with merely celebrating the singularity of our democratic system. They must ultimately acquire more weight of their own so that they are able to meet on equal terms the economic interests that they are supposed to regulate.

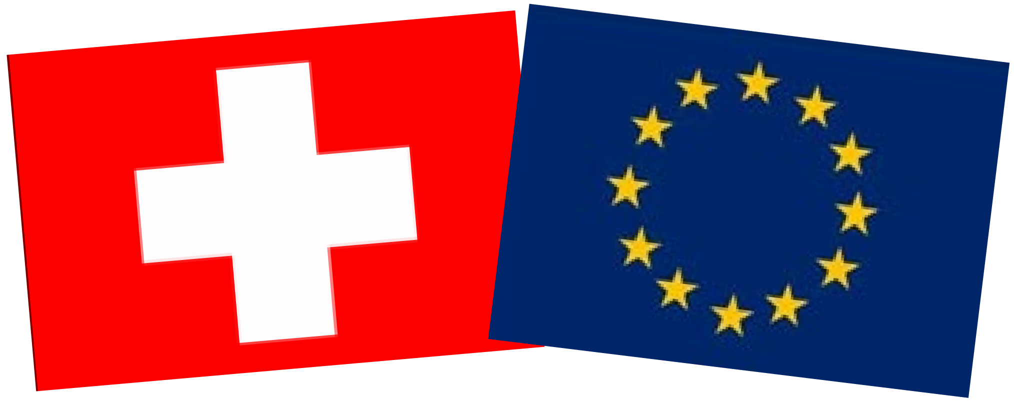
Peter Hablützel is a historian and political scientist. He served directly under several Ministers of Finance in Switzerland, lastly as Director of the Federal Office of Personnel (FOPER) between 1989 and 2005. Today he is a Consultant and freelance writer and commentator, and he is author of the book: ***Die Banken und ihre Schweiz. Perspektiven einer Krise****, published in April 2010 by Conzett bei Oesch Verlag, Zurich 304 pages, ISBN 978-3-0350-9006-2 (in German only)*

THE SWISS–EU TAX DISPUTE: ORIGINS AND PROSPECTS

feature

Thomas Cottier

For some three years, a dispute about tax privileges granted by Swiss Cantons to holding companies has overshadowed Swiss–EU relations. The dispute has not yet ended, and solutions are pending. The Swiss Government would be well advised to accept the EU Code of Conduct for business taxation as a basis for the future taxation of companies.



In June 2010 EU Finance Ministers mandated the Commission to reiterate talks on the tax dispute, and the Swiss Government agreed in August 2010 to exploratory talks, after having refused to enter formally into the matter for more than two years.

The dispute is a fundamental one. Tax, the Swiss government argues, is not subject to existing treaty relations and negotiations, and the EU has no say in matters exclusively pertaining to Swiss sovereignty and autonomy of the Cantons. The EU Commission, however, argues that exempting from tax the profits generated abroad by holding companies and related forms (such as letter box companies) resident in Switzerland amounts to distorting subsidies, contrary to Swiss obligations under the 1972 Free Trade Agreement (FTA). There is no dispute settlement mechanism available in EU–Swiss preferential relations, and neither party has shown an interest in submitting the matter to the WTO.

Both legal views are legitimate. Switzerland argues that the provisions on competition in the 1972 FTA do not legally include disciplines on subsidies, and says the EU has not been able to make specific allegations based on individual cases. The EU on the other hand, relies on early declarations which render all of competition law, including subsidies, relevant and applicable under the FTA. It also argues that the tax privileges nullify and impair the benefits of the agreement, and this entitles the EU to unilaterally suspend market access rights under Article 27 of the Agreement. The EU has not taken any formal steps to this effect – but it is no coincidence that no additional bilateral agreement has been concluded since 2004, despite some pressing needs, in particular in the field of energy. The tax dispute is a major thorn in bilateral relations.

Swiss blood pressure rises

The dispute has raised hackles in Switzerland. Because there is no judicial dispute settlement mechanism, the matter has moved into the arena of party politics. And the dispute risks being abused for electoral gain. Few politicians are prepared to acknowledge that the EU has a point: most assert that the tax system is a matter of national sovereignty and autonomy of the cantons, and there is little sympathy for the EU's view that tax exemptions are subsidies (and Swiss constitutional law lacks any provisions comparable to EU law in this area.) The dispute has been taken as a direct challenge singling out Switzerland, even though it was simply part of an overall

"The dispute has raised hackles in Switzerland. Because there is no judicial dispute settlement mechanism, the matter has moved into the arena of party politics – and the dispute risks being abused for electoral gain."

"the Swiss Government would be well advised to accept the EU Code of Conduct as a basis for future tax regimes. In the negotiations, it should put the emphasis on an appropriate time frame, and on solutions for the transition."

screening operation under the EU's 1998 Code of Conduct for Business Taxation and Tax Measures, and it also targets other countries. Few Swiss politicians acknowledge the initiative's backdrop: long-standing EU government efforts to secure fiscal revenues and combat tax evasion in member states; the high costs incurred by German unification, and new pressures resulting from the financial crisis.

The road block still needs to be removed, and the Swiss government's agreement in August to start formal consultations and explore the parameters of negotiations is important. The government has to save face: this affects tax revenues and income in about half the Cantons. In three of them -- Basel, Geneva and Zug -- corporate taxes from privileged companies add up to about a third of corporate income. The Swiss government, seeking to satisfy the EU and Member States, as well as the Cantons, is playing for time while the EU, in the current economic climate, is likely to ratchet up the pressure.

The EU is no longer prepared to rely on static bilateral agreements, but has insisted since 2008 on a more dynamic adoption of ongoing EU legislation. So it is likely to insist that, based upon the 1972 FTA, competition policy should include subsequent developments in disciplining subsidies and accept the EU Code of Conduct for Business Taxation.

A changing environment

The dispute also needs to be assessed in light of recent Swiss experience in international tax. Swiss banking secrecy has been eroding. The Swiss distinction between tax fraud and tax evasion no longer determines the new generation of double tax agreements. A dispute with the United States (see Andreas Missbach's article on Page 14) caused major legal and political turmoil, but finally drummed in the lesson that policies supporting tax evasion are a thing of the past. And the financial crisis has weakened the political influence of the finance industry and further undermined the foundations of past policies and beliefs.

Empowering the Cantons to introduce tax privileges for holding and similar companies, part of a long-standing strategy to attract company headquarters, has worked well for Switzerland and perhaps has been a key reason why Switzerland has abstained from EU membership. The strategy clearly gives these companies a competitive advantage in the European market: for example, a commodity transaction and shipment from a third country to the EU will neither be taxed in Switzerland nor in the EU, giving the Swiss-resident company a competitive edge over a company operating from within the EU.

The distorting and unfair effect is obvious. Discriminatory taxation is not sustainable and needs to be removed, according to the EU Code of Conduct (and those developed by the OECD). For the same reasons, letter box companies should be banned. External pressure from the EU will be supported by those Swiss Cantons not benefiting from the arrangement, and the Swiss public at large generally dislike tax privileges for the rich and wealthy.

The three cantons most affected are affluent, and can compensate affected companies by lowering general tax rates, which are already low by international standards. And EU law does not prevent tax competition, but merely imposes non-discriminatory taxation of similar companies, products and operations. In any case, companies will still see advantages in Switzerland beyond tax: its central location, efficient communications, stability, quality of life and educational facilities.

The world is changing: Switzerland needs to accept the Code of Conduct

For these reasons, the Swiss Government would be well advised to accept the EU Code of Conduct as a basis for future tax regimes. In the negotiations, it should put the emphasis on an appropriate time frame, and on solutions for the transition. It would be fair to let Switzerland get its house in order within five years of a settlement. In return, the EU should commit to swiftly addressing important issues, in particular in the fields of energy and chemicals, and temporarily extend the withholding tax regime[1] as Switzerland is not yet ready to accept an automatic exchange of tax information between banks and foreign tax authorities.

Conclusion

For Switzerland, recent experience has shown that its offshore policies have clear limits, and trigger resistance abroad. It is no longer possible to insist on national sovereignty while expecting to benefit from market access and economic integration in the EU. Swiss tax policies need to move towards a concept of cooperative sovereignty, taking into account the needs of all partners. It must accept that tax breaks may amount to subsidies with distorting effects, even though the Swiss Constitution is silent on the point. The impending settlement of the Swiss–EU tax dispute will be an important part of a learning process towards accepting the principles of multilayered governance in Europe. The settlement of the dispute will remove barriers to addressing more important issues, and further clear the road towards EU Membership in coming years.

Thomas Cottier is Professor of European & International Economic Law and Managing Director of the World Trade Institute, University of Bern, Switzerland.

1 Which is a temporary alternative to automatic information exchange allowed to some countries including Switzerland under the EU Savings Tax Directive .

KLEPTOCRATS: IS SWITZERLAND A DISAPPEARING PARADISE?

feature

Olivier Longchamp

The Swiss authorities happily present themselves as world champions in the restitution of illicit assets. But much remains to be done to trace dubious funds effectively.

Last June, Swiss Foreign Minister Micheline Calmy-Rey described Swiss policies on ill-gotten gains as "exemplary" and cast Switzerland as "a pioneer in the fight against funds of criminal origin."[1] This act of self-praise on the part of the Swiss authorities was not completely unwarranted.

According to the World Bank, the cross-border flow of the global proceeds from criminal activities, corruption, and tax evasion is estimated at between \$1 trillion and \$1.6 trillion per year, while corrupt money associated with bribes is estimated at at least \$20-40 billion per year or roughly 20-40% of global sums granted for public development aid. Yet the tracking of these illicit financial flows – which are devastating for countries of the South – is inefficient: in the past 15 years, only \$5 billion of stolen assets have been seized and returned. The Swiss, having returned about 1.7 billion Swiss francs to countries of the South, have played a role in bringing the subject of restitution of illegal assets to the international stage.

Switzerland's efforts may be commendable when compared with the inertia of other financial centres – but these are still not grounds for celebration. For years Swiss banks accepted dubious funds without hesitation, and any self-respecting dictator had to have a Swiss bank account. Criminal funds poured into Switzerland, and the amounts seized and returned do not suggest the Swiss authorities should be praised for their diligence in cracking down. In fact, the authorities are still rather timid.

"This draft Swiss law is a novelty in the international legal landscape, and Swiss federal authorities are delighted with it. But development NGOs consider it a disappointment"

During the 1980s and 1990s, the scandals caused by the discovery in Switzerland of assets of a string of kleptocrats – Duvalier and Marcos in 1986; Salinas in 1996 and Mobutu in 1997 – combined with frequent international criminal cases involving dubious Swiss financial relationships, especially in drug trafficking, caused considerable damage to the Swiss financial centre's image. The scandals contributed to the establishment of systems to detect and stop illicit financial flows, culminating in the adoption of the Anti-Money Laundering Act (AMLA) in 1998.

The Advantages of Self-Regulation

But the Swiss system to combat illicit financial flows is flawed. It leaves large parts of its implementation to the discretion of the financial intermediaries themselves. According to the AMLA, intermediaries must report transactions involving funds suspected of having a criminal origin to the Money Laundering Reporting Office Switzerland (MROS); and failure to do so is punishable.

The Democratic Republic of Congo struggled to get back money looted by former leader Mobutu Sese Seko. (Photograph from Wikipedia)

The Swiss Financial Market Supervisory Authority (FINMA) requires intermediaries to "consider business relations with politically exposed persons" as "cases presenting an increased risk" of criminal offence, and to adopt extra control measures.

But no private or public body other than the bank has information about the account holders, so it is hard to judge how well such directives are applied, and it raises

[1] During the Global Forum on Stolen Asset Recovery and Development, in Paris on June 8-9, 2010, organised by Swiss authorities and the World Bank

"By dragging its feet on international tax cooperation, particularly regarding the countries of the South, the Swiss authorities favour dishonest taxpayers in developing countries, and support a major loophole in their own system"

the question of how the authorities can ensure that the 325 Swiss banks respect the directives.

The MROS says that a steady increase in the number of suspicious activity reports by the banks proves the system is effective. This is going a bit far: in 2009, nearly 40% of all reports filed since 1998 to the law enforcement authorities were still being processed. Banks are not required to disclose when their clients engage in tax evasion, which is regarded as a mere administrative, not criminal, offence. So not reporting a client's questionable activities can be claimed to be justified, since the activity involves funds "only" coming from tax evasion.

Illicit flows, the tax evasion loophole, and difficulties in restitution

By dragging its feet on international tax cooperation, particularly regarding the countries of the South (see the articles by Andreas Missbach and Mark Herkenrath in this issue), the Swiss authorities favour dishonest taxpayers in developing countries, and support a major loophole in their own system: Calmy-Rey's comments must be taken with a large pinch of salt. In June 2010, the FATF said it hoped to tackle this loophole by making tax evasion a predicate offense for money laundering in future. Time will tell if the Swiss federal authorities, often lagging behind the FATF, will support this welcome shift.

Still reluctant to effectively prevent the inflow of illicit funds, the Swiss authorities prefer to highlight their actions in terms of asset recovery. Forced to a large degree by the action of a single activist magistrate in Geneva, Bernard Bertossa, significant amounts originating from countries in the South – notably the assets of the families of Sani Abacha ($700 million), Ferdinand Marcos ($684 million), Vladimiro Montesinos ($92 million), Kazakhstan ($84 million), Carlos Salinas ($74 million) and Angola ($21 million) -- have been at least partially returned since the 1990s by federal authorities to the countries where they originated from. Returned Swiss funds have typically been in the form of aid projects, and there is supposed to be some Swiss oversight over how the funds are spent.

But these restitutions have been problematic. For example, a World Bank report on the restitution of the Abacha funds to Nigeria explained how gaps in Nigerian public accounting made it impossible to verify the allocation of most of the returned funds, and 21% of the development projects financed by the restituted Abacha assets were terminated as soon as the funds were transferred to Nigeria!

LRAI

The Swiss Parliament approved a Law for the Restitution of Illegal Assets (LRAI) in September 2010. This law provides for the possibility of an independent procedure of confiscation for assets of politically exposed persons and their relatives, if funds are identified in Switzerland and the account holder is not able to prove their legal origin. The key concept here is that it reverses the burden of proof. This welcome law fills a gap often criticized by Swiss development NGOs. Until now, it has been impossible to confiscate such illicit funds without having a court order enforceable in the requesting country that is served, enacted in the context of international criminal cooperation. But it is well known that this is difficult for failing states, where the state apparatus and judiciary are ravaged by dictatorship, or subject to endemic corruption. Swiss development NGOs[1] regret the restrictive character of this new law, which can only be invoked when various conditions have been met, which are difficult to fulfill. The law also contains no provisions to allow civil society to initiate independent proceedings in Switzerland when the authorities in the country of origin of the funds do not act. Lastly, the law allows for restitutions made on the basis of "compromise agreements" as described above, which is very problematic from the point of view of the fight against impunity. The NGOs' detailed position is available in French and in German.

[1] In particular, Aktion Finanzplatz Schweiz, Fastenopfer, Alliance Sud, The Berne Declaration, and Bread for All

The return of Angolan funds deposited in Switzerland in the name of top Angolan dignitaries raises other questions. The (secret!) agreement signed in 2005 was a "compromise agreement" reached before final legal decisions were made on the nature of the funds seized in Switzerland. In this case the interests of the Swiss financial centre to get rid of troublesome assets quickly seems to have weighed more than the fight against impunity. The law (LRAI, see box) which seeks to generalise these types of deals should help prevent the recurrence of the fiasco with the Mobutu funds, which were blocked in Switzerland when he died but eventually returned to his family in 2009 because, among other things, the Congolese justice system was unable to prove the illegal origin of the funds. This Swiss law is a novelty in the international legal landscape, and Swiss federal authorities are delighted with it. But again, development NGOs consider it a disappointment, and are fighting to improve it.

Olivier Longchamp is a historian. He has been in charge of the programme "Fiscalité et Finances Internationales" at the Berne Declaration since April 2009.

SWISS ANTI-MONEY LAUNDERING: PROGRESS AND GAPS

feature

Daniel Thelesklaf

Switzerland has made distinct progress in its combat against money laundering. Yet there are still significant gaps. For as long as Switzerland fails to close these, money laundering will remain a low-risk business for perpetrators.

In early August 2010 the British security company Aegis Defence Services announced plans to transfer the seat of its holding company to Basel. The Chairman of the Board of Directors of the holding company is a manager at a Basel trust company, and Aegis said Basel was chosen because the trust company could advise the firm in legal matters.

Had the trust company been a bank, the Anti-Money Laundering Act (AMLA) would have required it to carry out a careful background check on Aegis -- a so-called "due diligence" exercise -- before the start of business. It is assumed that a bank would only accept such a client if a thoroughgoing examination of all circumstances has ruled out suspicion that the bank's business activities are violating any laws. If a bank fails to perform such due diligence, the Swiss Financial Market Supervisory Authority FINMA can intervene.

This duty to carefully clarify the financial background and continually to monitor business connections is a basic duty of any financial intermediary under the AMLA. Promulgated in 1998, the Act represented considerable progress. All financial intermediaries within its scope are required to report to the authorities if they suspect that assets entrusted to them are of criminal origin.

> *"As regulation in the banking sector as increased, money laundering activities have been shifting into less regulated sectors."*

However, as regulation in the banking sector has increased, money laundering activities have been shifting into less regulated sectors. Persons and companies from non-banking sectors are also being brought under the AMLA -- but only to a limited extent.

The AMLA's limited coverage

The international anti-money laundering standard is laid out in 40 Recommendations of the Financial Action Task Force on Money Laundering (FATF[1]). Switzerland was an FATF founding member and was once a driving force. There are concrete economic reasons for carefully implementing these Recommendations: non-observance can put a country on a blacklist.

The FATF Recommendations[2] list the persons and entities that should be subject to money laundering legislation. In addition to banks and insurance companies, these include a range of other players such as accountants, tax advisers, notaries, lawyers, trust and company service providers, real estate brokers, traders (if substantial cash payments are involved) and casinos.

Yet in Switzerland, the following branches and professions are not subject to the Act (so long as their role is "only" consultative):

Swiss secrets: The AMLA can only penetrate so far. (Getty images / Color Blind)

dealers in valuable items (e.g. Art dealers), real estate agents, tax consultants, as well as investment consultants, trustees, lawyers and notaries.

And here lies the snag: if the activities of the Basel trust company have been limited to consultancy for the purposes of establishing the holding company, they do not fall under the AMLA[3] and the trust company is under no legal obligation to conduct the due diligence exercise and is not subject to monitoring for this activity. There is also no reporting requirement in the event of

[1] The FATF is also known by its French acronym GAFI

[2] FATF Recommendation 12 and "Glossary" on the 40&9 Recommendations

[3] AMLCA Compilation on applicability, CA AMLCA, Subpara. 59

"Switzerland was the trailblazer in the fight against money laundering in the 1990s, but it is now following in midfield."

suspicion of money laundering. Commercial confidentiality would stand in the way of a report to the authorities, and money laundering would remain undetected.

Because all major financial centres have adopted a broader scope of application than Switzerland, there is the risk that such players may gravitate towards Switzerland on account of these gaps. This regulatory arbitrage is the booby trap that could mean damaged reputations in the future. It is interesting that the former pariah Liechtenstein has prudently brought the activities of trust companies comprehensively within the scope of anti-money laundering legislation.

Establishing the identity of beneficial owners.

This shortcoming in the AMLA is all the more regrettable because Switzerland has made considerable headway in other areas in the fight against money laundering, for example as regards establishing the identity of beneficial owners.

Identifying a beneficial owner is a core element of any modern anti-money laundering legislation. The FATF Recommendations[4] require that not only the customer must be identified, but also the person who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. In the case of legal entities, this verification must include measures to understand the ownership and control structures of the contracting partner. It is not enough in this process merely to rely on customer-supplied information. Such information must also be verified. This raises big challenges for contracting parties because they generally have no direct contractual link with the beneficial owner. They depend on the customer (the contracting partner) to provide information on the identity of the determining person who in fact controls the customer.

Switzerland was once a trailblazer in the introduction of the requirement to determine the identity of the beneficial owner. However, in Switzerland a financial intermediary may still work on the assumption that the contracting partner is identical with the beneficial owner;[5] and it is only when this is in doubt that the contracting partner must record the identity of the beneficial owner and request an appropriate declaration.[6] Unlike in other financial centres, this means that it is still possible for a legal entity itself be the beneficial owner – and not the persons who control the legal entity. This is a significant loophole.

Switzerland has been a path-breaker in another aspect of international regulation, namely the "risk-based approach," which aims to ensure a more targeted and efficient application of anti-money laundering regulations. The higher the risk that the assets involved may have money laundering connections, the more steps the financial intermediary must take to limit that risk. Switzerland introduced the risk-based approach in 2002 for banks, describing in detail the measures that must be taken in high-risk areas. Yet there are still gaps in the non-banking sector in this respect.

High reporting thresholds

The biggest shortcoming in Switzerland's anti-money laundering strategy is that the reporting requirement in the event of suspected money laundering is not sufficiently fleshed out. The reporting requirement was introduced in 1998, ultimately under pressure from the FATF, and it has long been controversial in Switzerland. The parliament attached unnecessarily high prerequisites to the reporting requirement: the basic principle remains that the transmission of customer data is fundamentally a breach of banking secrecy, and a waiver is only possible when "reasonable suspicion"[7] exists. The reporting threshold in Switzerland is considerably higher than in other centres. This accounts for the rather small number of reported suspected cases,[8] and the FATF criticized Switzerland on that score in its latest country review.

Last, there is no effective sanction mechanism in the non-banking sector. The fines envisaged under the AMLA are disproportionately low, and FINMA has very limited capacity to enforce sanctions. Since the assimilationof the Anti-Money Laundering Control Authority into FINMA as of January 2009, very little has been heard from FINMA regarding concrete sanctions for violating the AMLA.

Conclusion

Switzerland was the trailblazer in the fight against money laundering in the 1990s, but it is now following in midfield. Implementation is still at a high level, but when it comes to the non-banking sector and the reporting of suspect cases, the AMLA still has considerable shortcomings. The standard is higher in the banking sector precisely because the internationally active banks must conform to more than just the Swiss AMLA. Anyone who sits back and basks in Switzerland's best-in-class myth will ultimately suffer damage.

Daniel Thelesklaf is a Board Member of Transparency International Switzerland and Executive Director, Basel Institute on Governance. The article represents the author's personal opinions.

4 FATF Recommendation 5

5 Art. 3 VSB 08 [due diligence agreement [CDB] of the Swiss Bankers Association]

6 Art. 4 AMLA and Art. 4 VSB 08

7 Art. 9 AMLA

8 Under 1000 per year. Switzerland is the world's seventh biggest financial centre; Liechtenstein, which is one thirtieth the size, will soon have almost as many reports as Switzerland.

CRACKS IN THE ALPINE FORTRESS

feature

Andreas Missbach

As of 2009, the total protection of foreign tax evaders in the Swiss financial center is history. The United States cracked open the Swiss banking giant UBS and has forced the Swiss authorities to agree to the breach of bank secrecy laws. Threatened with OECD blacklisting, Switzerland ended its opposition to administrative cooperation to fight tax evasion. But despite these concessions, Switzerland continues to block effective measures on information exchange.

When Martin Liechti, the head of UBS private banking in the Americas was arrested in April 2008, the Swiss public was surprised to learn that the U.S. Department of Justice (DOJ) had initiated proceedings against UBS. Soon afterwards the U.S. Internal Revenue Service (IRS) filed a request for assistance with their Swiss counterparts: a major Swiss bank, already badly shaken by high-risk transactions in U.S. mortgage securities, had been fingered by a whistleblower.

Bradley Birkenfeld, a former UBS employee in Offshore Private Banking for U.S. clients, had supplied U.S. Authorities with juicy details. He described how UBS bankers broke commitments that the bank had made with the U.S. under a Qualified Intermediary Agreement (an arrangement under which foreign financial institutions are supposed to provide the IRS with information on U.S. Taxpayers) and how UBS had helped U.S. clients avoid reporting assets to the IRS using offshore constructions. Birkenfeld also revealed how UBS bankers based in Switzerland illegally solicited new clients in the U.S., and even how diamonds had been smuggled into the U.S. in a tube of toothpaste, to repatriate the proceeds of tax evasion.

"For individual tax evaders, the chance of getting caught based solely on Article 26 is very slim. And even this risk can be eliminated."

Bye Bye, Bank Secrecy

Threatened with prosecution in the U.S. -- which UBS might not have survived during the financial crisis -- the bank pushed the Swiss authorities to be allowed to cooperate with U.S. Authorities and to supply client data, in violation of Swiss bank secrecy laws. On February 18, 2009 UBS reached a Deferred Prosecution Agreement with the DOJ under which UBS paid a $780 million fine and provided the data on 250 clients. This required bank secrecy to be infringed, which the Swiss Finance Market Supervisory Authority (FINMA) duly arranged by reinterpreting the action, based on Articles 25 and 26 of Swiss banking law, as a protective measure to safeguard the interests of UBS' clients and the stability of the Swiss financial center. (It was a very creative interpretation of Swiss law: in January 2010 the Federal Administrative Court ruled that the release of data had in fact been illegal.)

The danger of imminent prosecution was averted, but the IRS was still not satisfied, and it launched a civil case against UBS. After further negotiations this was transferred in August 2009 into an agreement between the U.S. And Switzerland in which Switzerland had to supply account information for 4,450 of UBS' U.S. clients within a year. This agreement benefited from an exception that the U.S. had pressed for in its double tax agreement with Switzerland signed in 1951. Unlike other such agreements Switzerland signed, it addressed not just tax fraud but rather "tax fraud or the like" (and an 11-page Memorandum of Understanding from 2003 clarifies what "the like" means.) Creatively reinterpreting the term "tax fraud" allowed cooperation with the U.S. To be brought in line with the Swiss legal system.

With UBS' agreement, the U.S. obtained Swiss consent for a "fishing expedition" by which client data is located and turned over solely based on a description of facts on the part of the U.S., without mentioning names in the request. The newly-negotiated double taxation agreement between Switzerland and the U.S., signed on September 23, 2009, allows for "on-request" information exchange but excludes fishing expeditions. Based on the double tax agreement, U.S. Authorities therefore cannot carry out the same exercise with UBS or any other Swiss bank again.

"Birkenfeld revealed how UBS bankers based in Switzerland illegally solicited new clients in the U.S., and even how diamonds had been smuggled into the U.S. in a tube of toothpaste"

Administrative Cooperation: Yes. Effective Information Exchange: No

Beyond the U.S. case, the Swiss Federal Council (government) on March 13 2009 accepted Article 26 of the OECD Model Tax Convention, which also provides for administrative cooperation against tax evasion. Despite this historic concession, this is a decidedly blunt instrument (see Mark Herkenrath's article for more details). A request for cooperation must contain information about the bank account of a suspected tax evader, and almost the only way to get this information is from informants – but Switzerland has explicitly ruled out co-operating in the case of CD-ROMs of data provided by informants.

For individual tax evaders, the chance of getting caught based solely on Article 26 is very slim. And even this risk can be eliminated. If someone places their assets in a trust in Singapore before the new administrative cooperation agreements take effect (the Swiss banks, well represented in Singapore, can surely help!), they will not be affected by the cooperation, since it is not applied retroactively.

The New Line of Defense

It is hardly surprising that the banking lobby immediately accepted the expanded cooperation arrangement, even though Switzerland has officially and consistently opposed the corresponding OECD Article since 1998. But in early February 2010, when Finance Minister Rudolf Merz no longer categorically ruled out automatic information exchange, the reaction was swift: an internal paper of the FDP[1] Switzerland's traditional economic and banking party (to which Merz belongs) laid down a new line of defence on February 19:

> *"The protection of the client's privacy is synonymous with bank secrecy and the rejection of automatic information exchange."*

The pressure on Switzerland for automatic information exchange comes primarily from the European Union. Under the E.U.'s Savings Tax Directive, member states, with a handful of exceptions, already exchange information with each automatically on a multilateral basis. The exceptions include some EU members (Austria, Luxembourg and originally Belgium, as well as non-members including Switzerland, who have agreed to a witholding tax regime instead of automatic information exchange. For most of them (but not Switzerland) this

[1] The paper was written by bankers Konrad Hummler, a partner in Wegelin Bank; Christoph Ammann, Chairman of Bank Sarasin, and Professor Martin Jansen of the University of Zurich: *Strategie Finanzplatz Schweiz im Cross-Border-Geschäft. Vorschlag für eine politisch und wirtschaftlich tragfähige Lösung*, 19 February 2010.

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is a transitional arrangement on the way to adopting full automatic information exchange. separately, the United States is also applying pressure for automatic information exchange, but directly on the banks. The Foreign Account Tax Compliance Act (FATCA), passed in early 2010 and due to come into force on December 31, 2012, requires banks worldwide to adopt a version of automatic exchange of information.[2]

What about the rest of the money?

The advocates of the latest line of defense have a problem: what is to happen to the one to two trillion Swiss Francs of tax-evading money currently deposited in Swiss banks? A transition to automatic information exchange would prompt foreign tax evaders and criminals who don't wish to legalize their situation to move their money to other tax havens before any agreement enters into force.

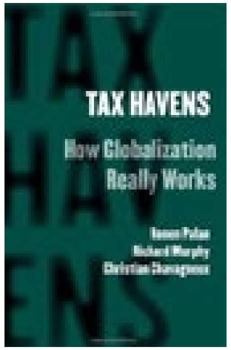
Thus the strong opposition from bankers and the idea of a withholding tax proposed by Finance Minister Merz, who recently stepped down. The FDP paper describes how the tax would work: a one-off lump sum payment that would be transferred to the tax administration of the client's home country, allowing tax evaders to legalise their assets without paying a penalty or tax. This, the paper's authors estimate, would yield 50 billion Swiss francs; afterwards, the tax evaders' tax liabilities would be satisfied by a yearly payment of from 0.5% to 1% of total assets.

[2] See TJN's April 2010 Briefing Paper on FATCA by David Spencer

With this, Switzerland is attempting to impose a one-time and permanent tax amnesty on countries losing revenues from tax evasion, which would lead to markedly lower tax for tax evaders than for honest taxpayers. Despite the calculated optimism coming from the Finance Ministry and banking circles, the E.U. And OECD categorically reject the idea. During a talk in Basel at the beginning of September, German Finance Minister Wolfgang Schäuble spoke about an agreement with Switzerland that would also include a withholding tax (as a pre-condition for negotiations on a new Double Tax Agreement that should start next year) – but with an "equivalent preventative effect" against tax evasion, such as automatic information exchange. We look forward to seeing the agreement. Negotiations should be concluded by the end of October.

Dr. Andreas Missbach is the head of the private finance programme at Berne Declaration, a founding member of the Tax Justice Network and of the NGO Network BankTrack.

reviews



Tax Havens: How Globalization Really Works

Ronen Palan, Richard Murphy and Christian Chavagneux

Cornell University Press, 2010

TJN's director John Christensen remembers a common saying in the tax haven of Jersey while he was Economic Adviser there, neatly encapsulating the secrecy and opacity that characterises these places: "Those who know do not talk, and those who talk do not know."

But it is not just secrecy and opacity that is the problem. There has been an almost wilful blindness on tax havens on the part of the world's academics, journalists and assorted pundits. Until very recently, there has been almost no serious research on tax havens (or secrecy jurisdictions, as we often prefer to call them.) So *Tax Havens: How globalization really works,* by Ronen Palan, Richard Murphy and Christian Chavagneux, which rightly calls itself the first ever comprehensive synthesis of the disparate strands of research and knowledge on tax havens, is such an important contribution to the literature. It is a useful and timely entry level text for researchers wanting to understand how tax havens fit into the contemporary political economy, the book contains the best overview yet of the global offshore system, complemented with many useful graphs, tables and case studies and a useful glossary.

First, a point of disclosure: Murphy is a senior adviser to TJN, and the book is clearly sympathetic to our perspective: it explores (and neatly skewers) various arguments that have been put forward in defence of tax havens, and lays out in some detail the various areas in which they have harmed people in the developed and developing world.

The book's central contention is that most of the accepted ideas about tax havens are false. They are not, as many believe, exotic oddities on the fringes of the global economy, but are central players in it: an integral part of modern business practice and one of the most important instruments in the contemporary, global financial system, and one of the principal causes of financial instability. Tax havens should not be seen as renegade actors operating in opposition to the state, but as close collaborators acting in accord with key players in supposedly "onshore" nation states.

The statistics are startling: about half of all international bank lending and 30 percent of all the world's stock of Foreign Direct Investment (FDI) are registered in the 46-60 tax havens reckoned to be in existence; the global rich held about $12 trillion in tax havens in 2007, and they host an estimated two million International Business Companies (IBCs), a "bewildering array of corporate entities, most of which are extremely opaque," which are a fundamental building block of the offshore system.

The offshore system did not spring up as a collection of atomised, self-serving jurisdictions exercising their sovereign rights to set their tax rates (and financial regulatory systems) as they please. Instead, as *Tax Havens* points out in a broad taxonomy of these disparate jurisdictions, they are creatures of state power – and most notably of Britain and the United States. In a section entitled "The British Empire Strikes Back," the authors show how leading tax havens – the Cayman Islands, Jersey and Guernsey, and many others, are not independent from Britain as many people suppose but are instead still half-attached to it; and they note that the British tax haven network of these semi-autonomous entities, plus former colonies such as Singapore and Hong Kong, accounted for a 37 percent share of all international banking liabilities (and 35% of assets) in 2008. Add the City of London itself, and (ignoring the possibility of double counting) the figure rises to 46 percent. A separate European pole, dominated by Switzerland, the Benelux countries and Ireland (although the latter has very close links to the City of London too) add a further 20 percent to this picture.

The book does get bogged down a little – as does anyone else who enters this minefield – in nailing down its definitions of tax havens. There is no broad international agreement on the differences between tax havens, financial havens, offshore financial centres (OFCs), regulatory havens, *paradis fiscaux* and other variants, and TJN has (mostly) enjoyed spirited internal arguments on this very question. We try to skip over the complexities wherever possible, and we have not offered a hard-and-fast TJN definition of tax havens. Nevertheless, TJN is extremely comfortable with the authors' contention that these are places that "create legislation designed to assist non-resident persons or corporations to avoid the regulatory obligations imposee on them in the places where those nonresident people undertake the substance of their economic transactions" – and the fact that they generally share an environment of secrecy that extends beyond the financial sphere and pervades the entire state, with the majority "controlled by a small, often invisible, oligarchy."

reviews
(cont'd)

The confusion over what constitutes a tax havens is important. It is one reason why so little good research has been done in the area: the most prominent tax haven lists, such as those produced by the OECD, are significantly driven by political expediency, and tend to leave out the biggest players in the system such as Britain and the United States, and other OECD member states. With such glaring excisions from the data, it is hard to conduct meaningful analysis of what is going on – and this book's more comprehensive analysis provides another vital contribution to the thin existing literature base.

The book also excels in exposing the sheer artificiality of what happens in the offshore world. Noting how a German dog called Günter was able to set up an anonymous trust in Liechtenstein (perhaps it was related to Monty Slater, a pedigree Shih-Tzu in Manchester, England who got a gold credit card from the Royal Bank of Scotland,) *Tax Havens* explores how income is relocated to jurisdictions where there is no real economic activity, with the result that tax and regulatory and other burdens on wealthy people and corporations are reduced, leaving the costs of running civilised societies to be picked up by everyone else.

The gymastics such jurisdictions engage in are, as the authors explain, often breathtaking. Take the IBC, whose principal purpose is to shift the profitable parts of a business to a low-tax jurisdiction, and to hide it. Responsible "onshore" jurisdictions, alert to the threat from IBCs, have taken steps to disallow these activities (where they are obviously a sham), and many now require them to undertake real activity where they do business. But if such a company becomes a "real" local firm in a tax haven, then they would get taxed under local tax laws. How, then, can these companies have a real presence in a tax haven, and escape tax? One answer is the so-called Exempt Company. Jersey legislation, for example, purports not to allow sham IBC incorporations, saying that a company is resident there "if its business is managed and controlled" in Jersey. But there is a loophole: "the office of director of an exempt company shall be deemed not to be an office exercised within the island." And with that neat trick, Jersey seeks to square the circle of disallowing sham corporations, while really allowing the shams to continue. A comment by Jersey politician Geoff Southern -- "We do an awful lot of 'deeming' in Jersey" – neatly encapsulates the artificiality.

These sort of things would almost be funny – if this were not such a deadly serious subject. And here *Tax havens* delivers again, exploring the range of harms that the offshore economy has caused to the world in general, and to developing countries in particular.

Review by ***Nicholas Shaxson****, editor of Tax Justice Focus and author of the forthcoming Treasure Islands: Tax Havens – The Darkest Chapter in Economic History Since the Slave Trade, (Random House, UK, January 2011; Palgrave MacMillan, USA, April 2011)*

news

The Yaoundé Declaration

Civil society organisations from Cameroon, Gabon, the Central African Republic (CAR), Democratic Republic of Congo (DRC,) the Republic of Congo and Chad, met in Cameroon and on September 9th issued the Yaoundé Declaration, declaring their intention to engage in supporting tax justice in their respective countries and recommended that the Governments of the Central African Sub-region and their partners:

1. Adopt fiscal policies that will enable an optimal collection of tax revenues and will combat illicit financial flows in order to achieve development;

2. Publicise national reports on tax system which could serve as a basis of support for national, regional and international campaigns and enhance the knowledge and understanding of stake holders on tax issues;

3. Support a participative, transparent, and responsible tax reform process;

4. Educate citizens on the importance of tax in development;

5. Strengthen the capacity of CSOs to monitor tax policies;

6. Ratify the African Union convention to fight corruption; and

7. Protect members of CSOs engaged in the campaign for tax justice.

The meeting and the declaration, organised by TJN4Africa and the Centre Régional Africain pour le Développement Endogène et Communautaire (CRADEC) and Dynamique Citoyenne, represent a tremendous step forwards in pushing the tax justice agenda forwards among the six members of the Communauté Économique et Monétaire de l'Afrique Centrale (CEMAC.)

news

Transfer Pricing Project

TJN has initiated a new project on transfer pricing, under the leader of TJN Senior Adviser David Spencer.

Transfer pricing happens whenever two related companies – that is, a parent company and a subsidiary, or two subsidiaries controlled by a common parent – trade with each other. This happens when, for instance, a US-based subidiary of a US multinational buys something from a French-based subsidiary of a US multinational. When the parties establish a price for the transaction, they are engaging in transfer pricing. This is not illegal or abusive in itself. However, these internal prices are often manipulated with the aim of shifting profits into low-tax jurisdictions and costs into high-tax jurisdictions, in order for the multinational to cut the tax bill. Given that an estimated 60 percent of world trade happens inside multinational corporations, this is one of the most important issues in international tax.

There has been very little work in this area by non-governmental organisations to date. TJN intends to change that. Currently, our work is focusing on fleshing out a section on the TJN website, describing transfer pricing practices and pointing to the various research that is out there on the subject. We aim to become more active on the subject in future, and to challenge a current OECD-dominated consensus on transfer pricing issues, and point to new approaches, with particular relevance for developing countries.

Sixth Session of the Committee of Experts on International Cooperation in Tax Matters

18-22 October 2010, Geneva

The main objective of the session will be to complete the revision of the United Nations Model Double Taxation Convention between Developed and Developing Countries, in accordance with the Committee's mandate. The session will also address important issues and proposals in other areas of the work of the Committee, such as for instance "transfer pricing" and capacity building in national tax systems.

Provisional agenda

1. Opening of the meeting by the Chair of the Committee.
2. Adoption of the agenda
3. Discussion of substantive issues related to international cooperation in tax matters:
   - (a) United Nations Model Tax Convention update;
   - (b) Dispute resolution;
   - (c) Issues related to attribution of profits under article 7 of the United Nations Model Convention;
   - (d) Transfer pricing: practical manual for developing countries;
   - (e) Article 13: capital gains;
   - (f) Taxation of development projects;
   - (g) Exchange of information ;
   - (h) Tax treatment of services;
   - (i) Article 14 of the United Nations Model Convention;
   - (j) Definition of permanent establishment: proposed revised article 5 Commentary;
   - (k) Concept of beneficial ownership;
   - (l) Revision of the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries;
   - (m) Capacity-building ;
   - (n) Tax cooperation and its relevance to major environmental issues, particularly climate change;
   - (o) Tax competition in corporate tax: use of tax incentives in attracting foreign direct investment.
4. Dates and agenda for the seventh session of the Committee.
5. Adoption of the report of the Committee on its sixth session.