Agreement between Switzerland and the UK on cooperation in tax matters

Regularization of past periods
I. Introduction

The landscape of banking secrecy and tax transparency has changed enormously in recent years. While the protection of banking clients' privacy is one of the pillars of Switzerland's financial sector, international pressure requires Switzerland to enhance its cooperation in the area of exchange of information in tax matters.

To address this, on 6 October 2011, Switzerland signed a landmark agreement with the UK that reconciles two principal concerns - the protection of Swiss banking clients' privacy and compliance with UK tax law. Changes to the terms of the agreement were subsequently announced on 20 March and 19 April 2012. The agreement is expected to enter into force from 1 January 2013, once its terms pass into law in Switzerland and the UK.

The agreement signed on 6 October 2011 originally also provided for a final withholding tax of 48% on interest income. On 20 March 2012, the agreement was amended to remove interest income from scope where tax is withheld at 35%, or a disclosure is made, under the terms of the European Union Savings Agreement (EUSA). Where tax is withheld under the EUSA, the bank will now also be required to withhold an additional 13% “tax finality payment”, meaning that the overall rate of withholding tax on interest is unchanged at 48%. A new provision was also announced for a withholding tax on the Swiss assets of a banking client who dies on or after 1 January 2013.

For the past, the agreement provides for a one-off flat-rate tax payment on financial assets held in Swiss bank accounts. The payment will be at a rate of between 21% and 41% and will clear past liabilities in respect of certain UK taxes.

The agreement consists of two core elements: a final withholding tax for the future and a one-off payment that clears the banking client's historic UK tax liabilities in respect of their undeclared Swiss assets. For the future, the agreement provides for a withholding tax of 40% on dividends, 48% on other income and 27% on capital gains. These are similar, but slightly less, than the highest UK tax rates. The tax will be deducted directly by the bank in Switzerland and will be passed to the UK tax authorities anonymously via the Swiss tax authorities. This will generally discharge the tax due in respect of the income or gains.

For both the one-off payment for the past and the final withholding tax for the future, special rules apply to banking clients who are UK resident but not UK domiciled. These rules are not discussed further in this booklet but more information is available from Ernst & Young on request.
Alternatively, banking clients can authorize their bank to disclose certain details to HM Revenue & Customs (HMRC). Those opting to do so will not be subject to the one-off payment for the past. If banking clients have unpaid UK tax in respect of prior years, those liabilities should first be separately disclosed by the client to HMRC by making a voluntary disclosure to an appropriate tax office or through HMRC’s Liechtenstein Disclosure Facility (LDF). This will require certain procedures to be followed and disclosure in respect of all tax irregularities, not just those in relation to Swiss assets. The total liability to tax, interest and penalties will depend on the facts of each case.

It is important that banking clients with undeclared income and gains consider which option would be most suitable to them: regularization by one-off payment under the agreement or a voluntary disclosure to HMRC?

The agreement will apply not just to banks but to all Swiss paying agents, a term which is broadly defined. For the purposes of this booklet, references to banks should be considered to apply to other types of paying agent.

Agreement between Switzerland and UK

Regularisation of past
- One-off payment on aggregate asset value covering certain taxes
- Implemented anonymously
- Optional: disclosure to tax authorities via the bank

Recurring final withholding tax
- Final withholding tax on future income and capital gains
- Implemented anonymously
- Optional: disclosure to tax authorities via the bank

Expected to enter into force on 1 January 2013
II. Regularization under the terms of the agreement between the UK and Switzerland

The withholding tax in relation to historic unpaid tax liabilities takes the form of a one-off payment at a rate of between 21% and 41% based on the financial assets held in Swiss bank accounts on a specific reference date. The tax rate will be calculated by way of a formula that takes into account a number of factors, such as the duration of the relationship with the Swiss bank and the amount on deposit at the specific reference date. Where the tax rate is 34% or more and the relevant capital amount in the account on 31 December 2010 was a £1m or more, the rate will increase by 1% for each additional £1m up to a cap of 41%.

The financial assets on which the one-off payment is charged are those that can be readily valued, e.g., currency and shares. The reference date is either 31 December 2010 or 31 December 2012, depending on the increase in asset value between those two dates. The payment is calculated and deducted by the bank and paid to HMRC anonymously via the Swiss tax authorities. There is no separate charge for late payment interest or penalties.

The payment will discharge historic liabilities to income tax, capital gains tax, inheritance tax and VAT in respect of the assets held in the Swiss bank account. It will not discharge any liabilities to corporation tax. Banking clients can choose not to be subject to the one-off payment by authorizing the bank to disclose details to HMRC. The bank will not levy the payment but will be obliged to reveal the identity of the banking client to HMRC along with past asset values and other information.

There are many banking clients who are already UK tax compliant, both in respect of the source of their Swiss assets and also the income and gains from them. For example, those who have already declared their Swiss income and gains on their tax returns. The one-off payment will still apply unless these banking clients give their consent that information in connection with their account can be passed to HMRC via their bank.
It is expected that banking clients that authorize the disclosure of information, and whose UK tax affairs are not up to date, will first make a voluntary disclosure to HMRC, either by contacting an appropriate tax office, or by making a disclosure through the LDF and making the appropriate payments direct to HMRC.

### Alternatives in order to become tax compliant

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III. Voluntary disclosure to HMRC

HMRC has a power to enquire into any tax return and launch an investigation into a banking client’s tax affairs. Where HMRC discovers that a banking client has not paid the correct amount of tax at the correct time, it will seek to recover unpaid tax and late payment interest. If they have failed to take reasonable care or have deliberately understated their income and capital gains, it may also seek to charge a penalty based on the amount of tax underpaid. For tax years up to and including 2010-11, the maximum penalty that can be charged is 100% of the unpaid tax. For subsequent tax years, HMRC can charge a penalty of up to 200% of the unpaid tax in respect of assets held in certain jurisdictions outside the UK.

A voluntary disclosure will help to reduce any liability to penalties as HMRC will take the disclosure into account when it decides the appropriate penalty percentage. A voluntary disclosure may also reduce the possibility that the client will be subject to a criminal investigation in respect of any tax offenses they may have committed.

There are various ways to make a disclosure to HMRC and it is recommended that advice is taken from an appropriately experienced and qualified advisor before proceeding. The options available can be divided broadly into two; a voluntary disclosure to an appropriate tax office or a disclosure through the LDF.

Making a voluntary disclosure to HMRC

HMRC will expect to receive a full and detailed explanation of the irregularities in the banking client’s tax affairs, together with computations that quantify the amount of additional tax payable. HMRC is also likely to ask for supporting information, documents or other evidence in support of the disclosure. It may also ask for a meeting. The banking client will be required as part of the disclosure process to make a disclosure of all tax irregularities, not just those in connection with assets held in Switzerland.

In cases where HMRC considers that the banking client has deliberately failed to declare income and gains, it can issue formal assessments of tax and penalties for a period of up to 20 years. When a voluntary disclosure to HMRC is made, the banking client will be expected to pay tax in accordance with HMRC’s ability to assess the unpaid tax, which may require payment of unpaid tax for up to 20 years.

Along with unpaid tax and late payment interest, HMRC is likely to seek a penalty. In deciding the appropriate penalty loading, HMRC will consider whether the banking client made a disclosure on a voluntary basis or was prompted to do so, whether they cooperated during the disclosure process and the seriousness of the particular offenses.
Once the disclosure has been quantified and agreed with HMRC, the banking client will be expected to enter into a contract to pay an amount in respect of the tax, interest and penalties due. If the irregularities are particularly serious and the amount of unpaid tax is significant, HMRC may decide to issue its Code of Practice 9 (COP 9). Under COP 9, HMRC will ask the banking client to formally agree to make a full and complete disclosure of all tax irregularities through a “Contractual Disclosure Facility.” HMRC will require a written outline of the tax offenses within 60 days, followed by a detailed report quantifying the additional tax and full payment of the tax, interest and penalties due. If the banking client denies the irregularities or does not agree to make a full and complete disclosure, HMRC will consider launching a criminal investigation.

The Liechtenstein Disclosure Facility
For many banking clients with irregularities in their tax affairs, it may be beneficial to make a disclosure within the terms of HMRC’s LDF. The LDF forms part of an August 2009 agreement between HMRC and the Government of the Principality of Liechtenstein. HMRC will permit banking clients to register for the LDF if they can demonstrate that they have an asset in Liechtenstein at the point at which they register. This must be accompanied by written confirmation from the Liechtenstein financial intermediary that the banking client has a substantial portion of the assets affected by the disclosure invested or managed in Liechtenstein, or that the client relationship is long term and is not merely of secondary importance. There is no other need to have a historic connection to Liechtenstein.

The LDF provides an opportunity to make a disclosure to HMRC on particularly beneficial terms provided certain conditions are met, although again the disclosure must be of all tax irregularities, not just those that relate to Swiss assets. Provided the banking client meets certain qualifying conditions, the LDF offers a number of beneficial terms including:

- A disclosure for all years 1999-00 onward only. No tax is due for earlier years.
- A fixed penalty. In the majority of cases, this penalty will be 10% for all years to 2008-09 and 20% thereafter.
- A “composite rate” of tax. To simplify the disclosure process, for all years to 2008-09, HMRC will allow the banking client to pay a composite rate of tax of 40% on all undeclared income, profits or gains to cover all of the taxes due.
- Immunity from prosecution, provided a full disclosure is made.
- HMRC will not publish the banking client’s name on a list of “deliberate tax defaulters.”
In order to qualify for the first three of the beneficial terms highlighted above, banking clients need to have held an offshore asset on 1 September 2009 that has given rise to tax irregularities. If the asset is a bank account, they will not qualify for those terms if it was opened through a UK bank branch or agency.

A registration for the LDF will not be possible where HMRC has already issued COP 9 or where the banking client has been arrested on suspicion of a tax offense. However, they will be able to register if they are currently subject to any other type of HMRC enquiry or investigation.
IV. Next steps in advance of 1 January 2013

The agreement provides UK banking clients with the opportunity to pay tax in respect of their Swiss assets without the need to take action themselves. This is because the withholding tax is calculated and deducted by the Swiss bank. However, the one-off payment does not take full account of a banking client’s facts and circumstances and, where relevant, will not clear all of the historic tax liabilities in all cases. In many cases, voluntary disclosure to HMRC will be the more effective and appropriate course of action.

The agreement is due to be implemented on 1 January 2013 and those affected by it must consider their options and decide which path to take. There are a number of issues to take into account and we strongly recommend that advice is sought from an appropriately experienced and qualified advisor. At Ernst & Young, we have a team of professional tax controversy specialists in Switzerland and the UK who can provide effective and thorough advice to banking clients seeking to regularize their tax affairs and, where appropriate, guide them through the HMRC voluntary disclosure process.
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