Failed Swiss-German tax treaty

Recommendations for German bank customers with untaxed assets in Switzerland
## Contents

<table>
<thead>
<tr>
<th>Topic</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>New framework for cross-border banking</td>
<td>4</td>
</tr>
<tr>
<td>Voluntary disclosure</td>
<td>6</td>
</tr>
<tr>
<td>Talk to us</td>
<td>10</td>
</tr>
</tbody>
</table>
Germany and Switzerland have failed to reach an agreement in their dispute over how to deal with untaxed assets held by German bank customers in Switzerland.

The “Treaty between the Federal Republic of Germany and the Swiss Confederation on Cooperation in Regard to Taxation and the Financial Market” dated 21 September 2011 and amended by protocol dated 5 April 2012 (tax treaty) has been rejected by the German opposition.

In view of the parliamentary impasse in Germany and election campaigning, it is not likely that the two countries will re-open negotiations in the near future on a full-scale fiscal amnesty to end their tax dispute. Switzerland has also ruled out talks on a new agreement.

What does the failure of the tax treaty mean for German investors?

Investors need to be aware that the failure of the treaty does not mean that there is no need to act. In fact, it means exactly the opposite.

There has been an explosion in the international exchange of information on tax matters over the last few years. The risk of untaxed assets being uncovered has grown sharply in Switzerland as well and is set to increase even further in the near future. By the same token, it is unlikely that German fiscal administrators and criminal prosecutors will scale back their investigations and stop buying tax CDs. What is more, Swiss banks are also expected to increasingly request their clients to retrospectively declare assets in an attempt to ward off further liability and reputational risks for themselves and the financial center of Switzerland.

This will place growing pressure on German investors to voluntarily declare their untaxed assets in Switzerland, pay back taxes and legalize their holdings in order to avoid prosecution for tax evasion.

In this brochure, we explain why becoming tax compliant is the only way forward and identify solutions for affected investors. We provide an overview of the new framework for cross-border banking and discuss how to pay taxes due on assets and legalize previously untaxed assets in Switzerland through voluntary disclosure.

We hope you find this brochure a stimulating read! Please contact us if you have any questions on voluntary disclosure.
New framework for cross-border banking

The regulatory framework for cross-border banking has undergone radical changes around the globe.

For German investors, the risk of detection in financial centers such as Switzerland, Liechtenstein, Luxembourg and Austria has risen sharply over the last few years as a result of new investigative possibilities available to the German tax authorities.

At the same time, Germany has tightened the screws on cross-border banking transactions.

Global exchange of tax information

Empty state coffers in the wake of the financial crisis have led to concerted action by the G20 countries and the Organization for Economic Cooperation and Development (OECD) to combat tax evasion. Bowing to international pressure, virtually all financial centers have agreed to comply with the OECD standards on transparency and exchange of information for tax purposes. The explosion in the automatic exchange of tax information is illustrated by the 800 new tax agreements which have been concluded in accordance with the new OECD standard since 2008 (see below).

New tax agreements worldwide since 2008

Figure 1

Source: OECD’s Current Tax Agenda, April 2011, p. 103
New double tax treaty between Switzerland and Germany

The revised double tax treaty with Switzerland (as opposed to the failed tax treaty in regard to taxation and the financial market) gives Germany, in specific cases, full access to all bank records in Switzerland for 2011 and subsequent periods where there is a concrete or founded suspicion of tax evasion. The widening of the OECD standard on the exchange of information for tax purposes to include group inquiries, as supported by Switzerland, will heighten the risk even further. The use of tax CDs, which continues to be tolerated in Germany, will also increase the risk of prosecution, including for periods prior to 2011. There are no signs that German fiscal authorities and criminal prosecutors will scale back their investigations. In all likelihood, Swiss banks will increasingly request their clients to retrospectively declare their assets in order to protect themselves and the Swiss financial center from further liability and reputational risks (white-money strategy).

Tightening of criminal tax law

In Germany, prominent cases of tax evasion and the most recent purchases of CDs containing tax data have shattered the image of tax flight as a minor and pardonable offense and paved the way for a tightening of criminal tax law. The German Annual Tax Act 2009, for example, extended the limitation period under criminal law from 5 to 10 years for especially serious cases of tax evasion.

In the same year, the German Federal Court of Justice ("Bundesgerichtshof") defined more stringent guidelines for setting penalties for tax evasion. In addition, the requirements for voluntary disclosure to avoid prosecution were tightened last year by the introduction of the Act on Combating Illegal Earnings ("Schwarzgeldbekämpfungsgesetz").

Note: Tax evasion (leading to a fine or imprisonment!) can only lead to prosecution if the offense is discovered before a voluntary disclosure has been made. A valid voluntary disclosure guarantees non-prosecution for tax evasion.

Salient features of the judgment by the Federal Court of Justice dated 2 December 2008 (1 StR 416/08)

The amount of the tax evaded is a decisive factor in assessing the penalty:

- Evaded taxes of more than EUR 50,000 per offense are normally considered especially serious cases.
- If only the tax claim was at risk (and no revenue has actually been lost), the threshold is EUR 100,000 per offense.
- A suspended sentence is normally imposed for tax evasion of more than EUR 50,000 (EUR 100,000) and up to EUR 1 million per offense.
- For evaded amounts of more than EUR 1 million, a prison sentence can only be suspended if there are especially significant mitigating circumstances.

Conclusion

In light of the global changes in the framework for cross-border banking and the harsher penalties being imposed for tax evasion, there is no real alternative to becoming tax compliant.

Swiss bank secrecy no longer affords German investors protection against criminal prosecution for tax evasion. The new double tax treaty between Germany and Switzerland has given German tax authorities the right to access all bank records in Switzerland if there is a concrete suspicion of tax evasion.

German investors should consider whether they can legalize their assets in Switzerland by making a voluntary disclosure in order to avert the risk of prosecution for themselves and their family.
Voluntary disclosure

The failure of the tax treaty means that voluntary disclosure with guaranteed non-prosecution is and will remain the only option available to German investors to legalize their untaxed assets in Switzerland. Voluntary disclosure allows taxpayers to become tax compliant and escape prosecution for the related offense.

Prerequisites

By making a voluntary disclosure, a taxpayer avoids punishment if all hidden accounts are disclosed in full to the German tax authorities before the tax evasion is detected and the tax owed is paid (plus a 5% surcharge if applicable) before the stipulated deadline.

Specifically, a taxpayer becomes exempt from punishment for all tax offenses which are not yet statute-barred under criminal law (after five or ten years, respectively) if he or she

- corrects and completes incorrect or incomplete information in full or supplies missing information and
- pays the evaded taxes in full before the appropriate deadline set by the tax authorities.

However, a taxpayer is not exempted from punishment (override effect) if, prior to making the voluntary disclosure,

- a tax audit notice is issued or initiation of criminal or administrative fine proceedings is announced,
- a magistrate appears in connection with a tax audit or investigation into a tax crime or tax offense,
- the offense is detected.
- For evaded taxes of more than EUR 50,000 per offense, exemption from punishment is conditional on timely payment of a 5% surcharge on the evaded taxes before the stipulated deadline.

Procedure

A voluntary disclosure can be made in one or two steps. Investors should carefully weigh up the pros and cons of the two options with their tax lawyer before deciding which procedure to use. Under the one-step procedure, a voluntary disclosure is only made after precisely calculating all the taxable income to be declared.

To be valid, a voluntary disclosure must be made before any offense is discovered, which often puts declarants under time pressure. If accounts are held abroad, it can take several weeks or longer to produce all the banking documents and carefully prepare them for tax purposes. Furthermore, banking documents are sometimes no longer available in full - in which case it is usually advisable to make a two-step voluntary disclosure based on an estimate.

Acting quickly by making a two-step voluntary disclosure is particularly advisable if there is an acute risk of an offense being discovered. This applies especially if offenses are likely to be identified due to a data CD as investors cannot be certain when the courts and the tax authorities will deem that an offense has been discovered, thereby rendering the voluntary disclosure invalid.
Stage one: The first stage in the two-step voluntary disclosure process is to make a generous estimate - as quickly as possible - of the income to be declared. It is vital that this estimate is not lower than the declarant’s actual income as this would invalidate the voluntary disclosure (failed voluntary disclosure). If all the other criteria for a valid voluntary disclosure are met (e.g., correct identification of the group of persons covered by the voluntary disclosure, disclosure of all tax-relevant matters, determination of the periods to be disclosed, no override effect), the investor can avoid punishment by making a voluntary disclosure based on an estimate.

Stage two: After the estimated voluntary disclosure is filed, stage two entails examining the investor’s bank documents in detail in order to calculate the exact amount of income, which is then declared to the tax office. As a rule, the tax authorities grant declarants a reasonable period for calculating their precise taxable income, rather than proceeding with an assessment based on the usually very high estimates given. However, should an assessment be made on the basis of an estimate, excessive tax backpayments can be avoided by appealing against the amended tax assessment notices within one month and by applying for a stay of execution.

Statute of limitations

For the voluntary disclosure to be valid, the declarant only needs to disclose the periods that are not yet statute-barred under criminal law. The limitation period under criminal law is 5 years in the case of simple tax evasion and 10 years for particularly serious cases (tax evasion of EUR 50,000 to EUR 100,000). The relevant limitation period is determined by the date on which the tax assessment notice is issued.

Nevertheless, the tax office will levy all taxes that were not statute-barred for tax purposes when the voluntary disclosure was filed (e.g., income tax, inheritance and gift tax). In the case of tax evasion, the limitation period for tax purposes is 10 years. This can be extended to as many as 13 years depending on whether and when tax returns were filed. In exceptional cases, transactions stretching back even further may also be taxed.
**Pitfalls**

The voluntary disclosure process entails a number of pitfalls and therefore should only be undertaken with the help of a specialist tax lawyer. Particular attention should be paid to the following points:

Voluntary disclosure only exempts the individual declarant from punishment. This means that only those persons who admit to having committed or been involved in tax evasion will avoid prosecution. The actions of all possible accomplices (e.g., spouse, parents, children) should therefore be examined independently to establish whether any offenses have been committed. If several accomplices are required to make voluntary disclosures, this process must be coordinated as closely as possible.

Voluntary disclosure only applies to tax evasion. Any other offenses committed, such as embezzlement or falsification of documents, remain punishable and any proceedings under professional or civil service law are also unaffected. Particular care should therefore be taken in voluntary disclosures filed by civil servants, judges and soldiers, as well as by certain professions (e.g., doctors, pharmacists, lawyers, tax advisors, notaries, auditors). Other non-tax-related consequences such as the revocation of a firearms certificate or the risk of failing the reliability test under the German Aviation Security Act ["Luftsicherheitsgesetz"] should also be considered.

Above all, the statutory enshrinement of the rulings of the Federal Court of Justice on the prohibition of partial voluntary disclosures in the Act on Combating Illegal Earnings dated 28 April 2011 led to a significant tightening of the rules on voluntary disclosures. Under these rules, voluntary disclosures are only valid if all offenses relating to a particular tax (e.g., income tax) that are not yet statute-barred under criminal law are disclosed in full.

**Costs**

As voluntary disclosure only leads to the taxation of actual investment income earned in the last 10 to 13 years, the total costs of voluntary disclosure (taxes, interest, any 5% surcharge, consulting fees) will often be less than 20% of the taxable Swiss assets. This means that, even under the now-failed tax treaty, voluntary disclosure would usually have been a much cheaper alternative: the anonymous one-time payment under the tax treaty would have resulted in the vast majority of investors handing over 21% to 41% of the value of their portfolios.

**Fear of being black marked**

Self-employed people often shy away from voluntary disclosure for fear of being black marked by the tax office. However, experience shows that this fear is usually unfounded as the tax authorities can generally distinguish between tax offenses in Switzerland and other income that is properly taxed in Germany.

**Closed accounts**

Declarants need to take action in respect of both existing and closed accounts. In Switzerland, a statutory document retention period of 10 years also applies to closed accounts. Furthermore, Switzerland provides administrative assistance for periods starting from 2011 under the current double tax treaty with Germany. It is also possible that German criminal prosecutors will gain knowledge of older accounts and portfolios through tax CDs or via third countries, for example. Closing an account does not eliminate the paper trail, the tax risk or the risk of prosecution.
Voluntary disclosure is the only way to legalize previously untaxed assets in Switzerland.

Encouragingly, voluntary disclosure has essentially been preserved despite stricter rules and prior legislative initiatives to the contrary. This instrument continues to allow taxpayers to become tax compliant while avoiding punishment.

The new rules laid down by the Act on Combating Illegal Earnings also enhance legal certainty with regard to the earlier rulings by the Federal Court of Justice and ensure a safe return to tax compliance for investors who are willing to make a voluntary disclosure.

In many cases, the total costs of voluntary disclosure (taxes, interest, consulting fees) are less than 20% of the investor’s taxable portfolio.

Voluntary disclosure

<table>
<thead>
<tr>
<th>Year</th>
<th>Portfolio</th>
<th>Taxable income</th>
<th>Taxes</th>
<th>Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>1,000,000 €</td>
<td>20,000 €</td>
<td>8,000 €</td>
<td>4,800 €</td>
</tr>
<tr>
<td>2003</td>
<td>1,000,000 €</td>
<td>20,000 €</td>
<td>8,000 €</td>
<td>4,320 €</td>
</tr>
<tr>
<td>2004</td>
<td>1,000,000 €</td>
<td>20,000 €</td>
<td>8,000 €</td>
<td>3,840 €</td>
</tr>
<tr>
<td>2005</td>
<td>1,000,000 €</td>
<td>20,000 €</td>
<td>8,000 €</td>
<td>3,360 €</td>
</tr>
<tr>
<td>2006</td>
<td>1,000,000 €</td>
<td>20,000 €</td>
<td>8,000 €</td>
<td>2,880 €</td>
</tr>
<tr>
<td>2007</td>
<td>1,000,000 €</td>
<td>20,000 €</td>
<td>8,000 €</td>
<td>2,400 €</td>
</tr>
<tr>
<td>2008</td>
<td>1,000,000 €</td>
<td>20,000 €</td>
<td>8,000 €</td>
<td>1,920 €</td>
</tr>
<tr>
<td>2009</td>
<td>1,000,000 €</td>
<td>20,000 €</td>
<td>5,275 €</td>
<td>1,440 €</td>
</tr>
<tr>
<td>2010</td>
<td>1,000,000 €</td>
<td>20,000 €</td>
<td>5,275 €</td>
<td>633 €</td>
</tr>
<tr>
<td>2011</td>
<td>1,000,000 €</td>
<td>20,000 €</td>
<td>5,275 €</td>
<td>316 €</td>
</tr>
<tr>
<td>Total</td>
<td>200,000 €</td>
<td>71,825 €</td>
<td>25,909 €</td>
<td></td>
</tr>
</tbody>
</table>

Voluntary disclosure

Costs of voluntary disclosure

<table>
<thead>
<tr>
<th>Costs of voluntary disclosure</th>
<th>€</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes</td>
<td>71,825</td>
</tr>
<tr>
<td>Interest</td>
<td>25,909</td>
</tr>
<tr>
<td>Consulting fees</td>
<td>30,000</td>
</tr>
<tr>
<td>Costs</td>
<td>127,734</td>
</tr>
</tbody>
</table>

\(^1\) Simplified overview for illustrative purposes
Talk to us

**Switzerland**

Our German private clients in Switzerland receive advisory services from experienced German lawyers and tax advisors at our German Tax & Legal Desk in Zurich, which is managed by Martin H. Seevers, who is a German lawyer and tax advisor. The address of our Zurich office is Maagplatz 1, 8005 Zurich.

In addition to our office in Zurich, 10 other Ernst & Young offices throughout Switzerland and in Liechtenstein are available for consultations.

**Germany**

In Germany, we have lawyers and tax advisors who specialize in providing advice on voluntary disclosure in our offices in Stuttgart, Munich, Düsseldorf, Hamburg, Berlin and Frankfurt.

16 other Ernst & Young offices throughout Germany are also available for consultations.

**International**

The offices in our international network are available to provide support for complex foreign matters (e.g., Austria, Luxembourg, USA).
Our experts are available for consultations throughout Switzerland and in many German cities. Your central contact for Switzerland and Germany is:

**Martin H. Seevers, Partner**
lawyer (Germany), tax advisor (Germany)  
Head of the German Tax & Legal Desk

**Switzerland**

Telefon  +41 58 289 39 35  
E-Mail  martin.seevers@ch.ey.com

**Germany**

Telefon  +49 160 939 16438  
E-Mail  martin.seevers@de.ey.com
About the global Ernst & Young organization
The global Ernst & Young organization is a leader in assurance, tax, transaction and advisory services. It makes a difference by helping its people, its clients and its wider communities achieve their potential. Worldwide, 167,000 people are united by shared values and an unwavering commitment to quality.

The global Ernst & Young organization refers to all member firms of Ernst & Young Global Limited (EYG). Each EYG member firm is a separate legal entity and has no liability for another such entity's acts or omissions. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients.

In Switzerland and Liechtenstein, Ernst & Young Ltd is a leading audit and advisory firm with some 2,100 people at 11 locations. The firm also provides tax, legal, transaction and accounting services. In this publication, “Ernst & Young” and “we” refer to the Ernst & Young Ltd, the Swiss member firm of Ernst & Young Global Limited.

For more information, please visit www.ey.com/ch

© 2013 Ernst & Young Ltd
All Rights Reserved.

MLA 0113

This publication contains information in summary form and is therefore intended for general guidance only. Although prepared with utmost care this publication is not intended to be a substitute for detailed research or the exercise of professional judgment. Therefore no liability for correctness, completeness and/or currentness will be assumed. It is solely the responsibility of the readers to decide whether and in what form the information made available is relevant for their purposes. Neither Ernst & Young Ltd nor any other member of the global Ernst & Young organization can accept any responsibility. On any specific matter, reference should be made to the appropriate advisor.