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Swiss International Cooperation in Tax Matters and Bank Secrecy



Similar to other countries like Austria, Liechtenstein, Luxembourg and Singapore, Switzerland is amending its double taxation conventions to adopt Art 26 of the OECD Model Convention. This article explains how Switzerland is implementing the new rules and what special arrangements are envisaged with respect to major European countries.

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Recently, the scope of Swiss bank secrecy has been the subject of intensive international debate. Swiss bank customer secrecy, however, has not been and will not be abolished. Swiss bank customer secrecy rules are not and never have been absolute. Swiss bank secrecy does not protect an account holder in case of criminal activities, including defrauding the (Swiss or foreign) tax authorities.

In particular, there has been criticism by foreign jurisdictions and the OECD that under present rules and double tax conventions (DTCs), Switzerland has no obligation to provide client account information to foreign authorities in case of simple tax evasion as opposed to tax fraud in the area of direct taxes.

In the light of this recent development, the Swiss government has renegotiated a large number of its DTCs and is still negotiating new ones to the effect that foreign authorities will have the right to claim administrative assistance and information sharing not only in cases of tax fraud and the like,

but also in individual, sufficiently substantiated cases concerning foreign taxpayers.

However, Switzerland has not agreed and does not intend to agree to automatic information exchange or information exchange upon a request which is not sufficiently substantiated. This distinguishes Switzerland from many foreign countries where the tax authorities may access customers' bank account details at all times (to some extent even online and without the customer's knowledge) and without specific justification.

Furthermore, people who are residents in Switzerland exclusively for tax purposes need not be concerned about these recent developments because Swiss banks continue to be prohibited from sharing client account information with the Swiss tax authorities even in the case of mere tax evasion of direct taxes.

The Status Quo on the Exchange of Information in Tax Matters

Judicial Assistance

According to the Act on International Criminal Assistance of 20 March 1981 (IMAC), the Treaties on Mutual Assistance in Criminal Matters and

the European Convention on Mutual Assistance in Criminal Matters, Switzerland is prepared to exchange bank information if a tax fraud has been committed. Further assistance is granted under the Bilateral II treaties with the European Union (Fraud Agreement and Schengen Agreement). According to these treaties, bank information can also be obtained in cases of tax evasion. However, only information on indirect taxes such as value-added tax can be obtained but not information on direct taxes (ie taxes on income and on capital).

Administrative Assistance

1. DTCs

Under the vast majority of DTCs, bank information cannot be obtained. However, according to Switzerland's DTCs with the United States, Germany, Finland, the United Kingdom, Norway, Austria, Spain, Costa Rica and South Africa, bank information can be obtained if tax fraud or the like has occurred.

2. Treaty on Taxation of Savings

According to the Treaty on Taxation of Savings, bank information can also be obtained in cases of tax fraud or the like, in relation to member states of the European Union. However, the exchange of information is limited to the income which is covered by the treaty, ie interest (it is controversial whether the obligation to exchange bank information also applies to dividend payments and royalties). In a separate Memorandum of Understanding, Switzerland made a commitment to amend its DTCs and exchange information for all taxes mentioned in the DTCs, if tax fraud or the like has occurred.

3. Fraud Agreement

Bank information can also be obtained in case of tax evasion under the fraud agreement with the European Union. However, such information will only be available with regard to indirect taxes (eg value-added tax) and not direct taxes.

Forthcoming Developments in Exchange of Information in Tax Matters

Judicial Assistance

On 29 May 2009, the Swiss Federal Council (SFC) decided to implement enhanced administrative assistance by agreeing to exchange information not only in cases of tax fraud but also in relation to judicial assistance. This decision could lead to an amendment of the treaties on mutual assistance in

criminal matters and at a later stage an amendment to the IMAC.

Administrative Assistance

On 13 March 2009, the SFC decided to adopt Art 26 of the OECD Model Agreement in its DTCs. The aim of the SFC to amend at least 12 DTCs by autumn 2009 was achieved. By mid-October 2009, Switzerland had signed 12 DTCs (with Austria, Denmark, the Faroe Islands, Finland, France, Luxembourg, Mexico, Norway, Qatar, the UK and the US) which now include Art 26 of the OECD Model Agreement. A revised agreement with Spain is also considered to have been signed. The existing DTC with Spain contains an automatic most-favoured nation clause which will be activated if Switzerland agrees to a more onerous, far reaching provision with another EU state. This clause was activated by the signing of the DTC with Denmark on 21 August 2009.

Meanwhile, Switzerland has concluded 31 revised and new DTCs which contain an exchange of information clause according to Art 26 of the OECD Model Convention (apart from the above mentioned DTCs: with Canada, Germany, Greece, Hong Kong, India, Ireland, Japan, Kazakhstan, Netherlands, Oman, Poland, Romania, Singapore, Sweden, Slovakia, Taiwan, Turkey, United Arab Emirates, Uruguay. The revised DTCs with Denmark, France and Luxembourg are already in force. The DTCs with Austria, Finland, Mexico, Norway, Qatar, the UK and the US are ready to be ratified.

Once the amendments to each DTC are signed by both parties, it is also necessary for the amendments to be approved, on the Swiss side, by the Swiss parliament. This will take at least three to six months. The parliament will also decide if the amendment should be put to the so-called facultative referendum and if so, then a public vote would be required.

The DTCs with Japan, the Netherlands, Poland and Turkey are expected to be ratified in the summer 2011 while the DTCs with Canada, Germany, Greece, India and Uruguay are to be ratified in autumn 2011.

The amended DTCs provide for the following protective elements:

- The exchange of information will be limited to taxes covered by the DTCs (ie direct taxes). However, some of the new DTCs (eg with France, Germany, Japan and the UK) do not

limit exchange of information on taxes covered by the DTC but will extend to other taxes eg value-added tax and inheritance tax.

- The exchange of information will also be granted if the information is requested for a person who is not a resident of the contracting states.
- Generally, only information which concern the period of time following the entry into force of the amended DTCs will be exchanged. Therefore, retroactivity should be, on the whole, avoided. However, it should be mentioned that under some DTCs, information will be granted for earlier time periods. In the new treaty with France, for example, the exchange of information clause will be applied to calendar years and business years as from 2010. Under the new treaty with the US, bank information can be obtained from the date of signature of the agreement, ie 23 September 2009. Under all new treaties, information will only pass the Swiss border if these treaties have entered into force, ie the earliest by the end of 2010.
- The exchange of information will only be granted upon request. It must be noted that the automatic or spontaneous exchange of information has been explicitly excluded.
- The SFC stated that it will not be prepared to exchange information in case of so-called 'fishing expeditions'. Thus, the new DTCs explicitly define what is understood to be a fishing expedition. Therefore, the tax authorities of the requesting state are explicitly obliged to substantiate an information request with the following:
 - Name and address of the tax payer (if possible also other information, such as date of birth, marital status, tax identification number).
 - The time period for which the information is requested.
 - Substantiation as to why the information is 'foreseeably relevant'.
 - Name and address of the information holder (ie the name of the bank). In the new DTC with France, it is also acceptable, if the bank account is identified by other means (eg an IBAN number). It will be of utmost importance how the Swiss Federal Tax Administration interprets these requirements.

– Description of the information requested.

- The new DTCs also determine that administrative assistance procedures will be respected. This means, from a Swiss point of view, that client data information would be only transmitted to the requesting contracting state if the tax payer has exhausted all administrative procedural rules. For example, it will be possible to appeal against the decision of the Swiss Federal Tax Administration as to whether or not the information sought should be transmitted abroad. Only if this appeal is rejected by the Federal Administrative Court, can information pass the Swiss frontier.
- Another principle which is part of the amended DTC is that of subsidiarity. This means that a request for exchange of information will only be granted once the requesting contracting state has exhausted all regular sources of information available under its own internal taxation procedure.
- From a Swiss point of view, the question of stolen bank data is very sensitive. Last year, a former employee of an HSBC private bank in Geneva stole client data that was handed over



to French authorities. Also, some stolen Swiss bank data that was contained in several CDs purchased by the German authorities were passed on to other countries. Based on such experiences, the Swiss parliament has decided that the SFC must declare to its treaty partners not to exchange information in case of stolen bank data.

Supplementary Agreements

Apart from the revised DTCs which contain Art 26 according to the OECD standard, at the end of October 2010, the Swiss Minister of Finance signed declarations on the initiation of negotiations concerning financial and tax matters with UK and Germany. The ministers of finance reaffirmed the willingness of their countries to further intensify cooperation in financial and tax matters and to strengthen long-term legal security for market participants. By the joint declaration, the ministers agreed to initiate negotiations on the expansion of cross-border cooperation in tax matters and improved market access for banks. Negotiations will be based on the exploratory talks conducted by a joint working group which were held recently. Negotiations expected to commence at the

beginning of 2011 and as soon as the governments have issued their respective mandates. The outcome of the negotiations will then be submitted to parliament. It is expected that similar negotiations will also be conducted with other major European states.

The governments of Switzerland, with the UK and Germany respectively, are confident that the negotiations will lead to a fair and lasting solution in the interests of their states. The parties agree that a new solution would enable distortions in competition, in terms of tax issues, to be avoided. UK and German taxpayers should not be deterred from holding a bank account in Switzerland. In future, however, the possible risk of tax evasion should not impact on the investment decisions of UK and German taxpayers.

During the exploratory talks, Switzerland and the UK and Germany respectively, agreed on a lasting solution that respects the protection of bank client privacy. Consequently, the automatic exchange of information will no longer be an issue in relations between Switzerland and the two states. The solution will apply after the entry into force of the agreement to be negotiated (with no retroactive effect).

The solution, the details of which are to be clarified during the negotiations, covers the following points in particular:

- Regularisation of the past: untaxed existing assets should be regularised.
- Final withholding tax for the future: future investment income should be covered by a withholding tax, the rate of which has yet to be negotiated. The final withholding tax is a tax at source. After it has been paid, the tax obligation towards the country of domicile will have been fulfilled. Extended administrative assistance has been agreed in order to prevent any possibility of circumventing the withholding tax. This envisages that the UK and German authorities can submit a request for administrative assistance that states the name of the client, but not necessarily the name of the bank. The number of requests that can be submitted is limited and must be well-founded. Fishing expeditions are not permissible.
- Further elements: Switzerland and the UK and Germany respectively, intend to tackle the issue of market access for Swiss financial institutions in the UK and in Germany. The package



includes measures to decriminalise banks and their staff.

It is not guaranteed that the envisaged supplementary agreements will pass the Swiss parliament. The success of such negotiations will depend to a large degree on the withholding tax rates which will be levied. If they are too high for the foreign investors, it seems logical that they will withdraw their money and go elsewhere. Apart from Singapore and Hong Kong, German investors could, for example, consider opening an account in Austria which does not levy a comparable withholding tax. However, the extension of the exchange of information clause could encounter serious opposition in the Swiss parliament. The competent commission of the Council of States has already announced that it will refuse the approval of an exchange of information clause which goes beyond Art 26 of the OECD Model Convention.

It is expected that such supplementary agreements will not enter into force before 2012. Thus they could probably be applied in 2013 at the earliest.

Current Status of Amending the DTCs

Since the decision of 13 March 2009 and after having been 'grey-listed' by the OECD, Switzerland has signed 19 DTCs containing an extended administrative assistance clause in accordance with Art 26 of the OECD Model Convention. Consequently, Switzerland has been removed from the 'grey list' of the OECD's

Secretariat. Further agreements have been initiated and others will follow in accordance with the OECD Model Convention.

Conclusion

According to the new DTCs, the exchange of information clause will not require a specific type of tax offence. However, exchange of information will only be granted if the requesting state indicates the names and addresses of the tax payer and the information holder (name of the bank), as well as the reason why the information is sought.

It will be possible to appeal against the decision of the Swiss Federal Tax Administration as to whether the information sought will be permitted to be transmitted abroad. It is only when this appeal is rejected by the Federal Administrative Court can information pass the Swiss frontier.

The first amended DTCs (with Denmark, France and Luxembourg) entered into force in 2010. This means that the first requests for exchange of information can be made relating to the period from 2010 with France, and 2011 with Denmark and Luxembourg, and onwards. It is expected that the ratification of other treaties will follow soon.

The supplementary agreements that Switzerland will negotiate at the beginning of 2011 go far beyond the OECD standard and depending on their content, they could provoke substantial restructuring of investors and serious opposition in the Swiss parliament. It is not expected that these agreements will enter into force before 2012 so the earliest application of these agreements will probably be in 2013 at the earliest.