UK-Swiss Tax Agreement

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CATEGORY:
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Introduction

On 6 October 2011 the UK and Switzerland signed and published the text of their tax agreement for UK residents with accounts in Switzerland (the 'Agreement'). The publication of the Agreement is good news in that it provides welcome clarification on a number of issues which (as mentioned in our previous Stop Press dated 13 September 2011) had been unclear from the information published previously. On the other hand, it has also confirmed that the Agreement has some significant limitations.

The Agreement still needs to be ratified by the Swiss and UK parliaments before it can enter into force, but is currently expected to take effect on 1 January 2013. In the meantime, individuals who will be affected by the Agreement will need to consider their options carefully.

Who is affected by the Agreement?

The Agreement will apply to UK-resident individuals holding bankable assets in an account in Switzerland. This includes individuals who are resident but not domiciled in the UK, although if these individuals claim the remittance basis they will be subject to different rules to reflect this.

Points to note

- In certain circumstances an individual will be treated as UK resident for the purposes of the Agreement even if he/she does not actually live in the UK. This applies where a client has given a UK address to the bank as his principal residence. Also, a new client (i.e. one who opens a Swiss account after the Agreement enters into force) will be deemed to be UK resident if he has a British passport on record and cannot provide a certificate of residence outside of the UK.
- It has now been confirmed that the Agreement will extend to accounts held by trusts, foundations, offshore companies, other legal entities and insurance wrappers where the beneficial owner is a UK resident individual (i.e. the Agreement will disregard the entities). However, the Agreement will not apply to structures where beneficial ownership cannot be ascertained, such as discretionary trusts. Whether entities will be disregarded will depend on the beneficial owner information kept by the relevant bank.
- The Agreement will not apply to an individual if he closes his Swiss account before the Agreement comes into force.

Scope of the Agreement – UK domiciled individuals

Regularising the past

A UK taxpayer who had a Swiss account open on 31 December 2010 (and still open on 31 May 2013) and who does not qualify for the special rules available to non-UK domiciled individuals will either have to allow his bank to deduct a one-off payment on an anonymous basis or authorise the bank to provide H.M. Revenue & Customs (HMRC) with details of his account. The amount of the one-off payment is calculated using a formula which takes into account the values of the taxpayer's accounts in 2002 (or the date it was opened if more recent than 2002), 2008, 2010, 2011 and 2012. The Swiss Bankers' Association estimates that for most taxpayers the payment will equate to 20% to 25% of the value of the account.

A UK taxpayer who is already compliant will have to allow the bank to provide HMRC with details of his account in order to avoid the one-off payment.

Points to note

- The one-off payment will clear a taxpayer's past liabilities to UK income tax, capital gains tax, inheritance tax and VAT which arose on the Swiss accounts before 2013 and effectively 'clears' a specific value of funds on the Swiss account. If the taxpayer has any other outstanding liabilities, these will not be covered under the Agreement.
- If funds have been withdrawn from the account, these funds will not be cleared by the one-off payment.
- The clearance for past liabilities only applies if the taxpayer opts for the one-off payment.

To qualify for the full benefit of the one-off payment, a UK taxpayer must not:

- be under investigation by HMRC at the date the Agreement comes into force (probably 1 January 2013);

- have been contacted specifically by HMRC in relation to any previous UK disclosure facility (e.g. Offshore Disclosure Facility in 2007 or New Disclosure Facility in 2009); or

- have failed to disclose the Swiss account to HMRC during the course of an investigation concluded since 2002.

- The clearance for past tax liabilities will include any interest, penalties and surcharges that may be chargeable in relation to those liabilities (but not any other outstanding liabilities).
- The one-off payment does not provide guaranteed immunity from prosecution.

Future tax years (2013 onwards)

Once the Agreement comes into force, the default position is that UK resident and domiciled individuals will suffer a withholding tax on income and capital gains derived from funds held in a Swiss account. The withholding tax rates applicable from 2013 onwards are 48% on interest income, 40% on dividend income and 27% on capital gains. Again, the deductions will be levied on an anonymous basis.

Points to note

- The withholding of the tax by the financial institution will render the client UK tax compliant in relation to the assets in the Swiss account (but not in relation to any other assets or profits).
- The withholding rates are higher than the rates applicable under the agreement between Switzerland and Germany and are only marginally less than the actual maximum UK rates. If UK tax rates change in the future, the withholding rates will also be adjusted accordingly.
- A taxpayer will not be able to apply allowances against his liability to the withholding tax, but will be able to have losses carried forward in the Swiss account.
- The withholding tax will not apply if a taxpayer authorises the bank to provide HMRC with details of the income and gains generated by the account. He will then be required to report income and gains on the Swiss account in his future tax returns in the normal way.

Scope of the Agreement – non-UK domiciled individuals

The Agreement applies special rules to non-UK domiciled individuals to reflect the way they are normally taxed in the UK. It is important to note that not all 'non-doms' can benefit from the special rules: only those who have elected to be taxed on the remittance basis for the 2010/2011 or 2011/2012 tax year can opt out of the one-off payment for the past, and only those who elect to be taxed on the remittance basis in future tax years qualify for the special rules relating to the withholding tax. Swiss banks will only be allowed to apply the special rules if the account holder's tax status has been certified annually by a UK lawyer, accountant or tax advisor.

Non-doms who do not qualify for the special rules will be treated in the same way as UK resident and domiciled taxpayers.

Regularising the past

A qualifying non-dom has four choices for dealing with past tax liabilities:

1. make the one-off payment (in the same way as for a UK domiciled individual);
2. voluntary notification to HMRC;
3. authorise the bank to make a payment in respect of all untaxed UK source income and gains which arose on the account and non-UK source income and gains which have been remitted to the UK since 2002
4. opt out of the Agreement (by confirming to the Swiss bank that he does not wish to use any of the other three options).

Points to note

- The one-off payment (option 1 above) will be levied automatically unless the account holder exercises one of the other options by 31 May 2013. Even an account holder with no undisclosed liabilities will need to exercise another option in order to avoid the one-off payment.
- Although the one-off payment is potentially the most expensive option, it may be advantageous as it looks as though it may effectively capitalise accumulated unremitted income and gains in the accounts.
- As for UK domiciled individuals, the clearance for past liabilities only applies if the taxpayer opts for the one-off payment, and again no immunity from prosecution will be given.
- The Agreement does not state whether any payments from the account to HMRC could be treated as taxable remittances.

Future tax years (2013 onwards)

Once the Agreement comes into force, a qualifying non-dom will automatically be subject to the withholding tax on UK source income and gains and on foreign source income and gains which have been remitted to the UK, unless he permits the bank to provide HMRC with details of such income and gains. He will not be able to opt out of this part of the Agreement.

Points to note

- Payment of the withholding tax will only satisfy a non-dom's tax liabilities in relation to the Swiss account if any remittances are made directly to the UK or the bank is informed of any indirect remittances to the UK. If this is not the case, the withholding tax will only be treated as a payment on account of taxes due.

- As mentioned above, an account holder will not qualify for these rules (i.e. he will be treated in the same way as a UK domiciled individual) unless his tax status is certified annually.
- Increased withholding tax rates (50% on interest income, 42.5% on dividends and 28% on capital gains) will apply where a taxpayer has informed the Swiss bank that he intends to claim the remittance basis for the relevant tax year but his status has not been certified within the deadline specified in the Agreement. Also, the failure to obtain certification means that the taxpayer will not qualify to be treated as a non-dom, so the withholding tax will be levied on an arising basis.

What next for UK account holders?

Even though the Agreement will not enter into force until 2013 at the earliest, any individual who will be affected by it should start reviewing his options sooner rather than later, particularly if he has undisclosed tax liabilities.

Regularising past liabilities: one-off payment or LDF disclosure?

On the face of it, a one-off payment under the Agreement is an attractive option for regularising past liabilities. Apart from the fact that it allows an account holder's anonymity to be preserved, the process is likely to be simpler – and may in some cases be cheaper – than a disclosure using the Liechtenstein Disclosure Facility ('LDF'). For remittance basis users, there is the further potential advantage that it appears that the one-off payment may effectively capitalise any accumulated foreign income and gains in the Swiss account.

On the other hand, a one-off payment has a number of significant limitations as compared with an LDF disclosure, e.g.:

- a one-off payment may not clear off all the account holder's tax liabilities (for example if he has other liabilities which are unrelated to the funds in the Swiss account);
- withdrawals from the account will not be cleared (and it appears that the same may apply to bank charges), although it may be possible to add funds back to the account in order to obtain clearance;
- the clearance given in relation to the one-off payment will only cover tax liabilities of the individual account holder, as opposed to liabilities of any related entities (e.g. trusts, foundations, offshore companies);
- the one-off payment is only an option for a taxpayer who has a Swiss account which was open on 31 December 2010 and is still open in 2013. In contrast, the LDF can be used by a taxpayer who has no prior connection with Liechtenstein;
- the LDF offers immunity from prosecution, whereas the Agreement does not;
- eligibility for the one-off payment is more restricted than for the LDF (as it excludes anyone who has been investigated by HMRC in the past);
- we anticipate that in many cases the LDF is likely to offer a cheaper option than the one-off payment.

It is also important to bear in mind that the LDF allows an account holder to regularise his tax affairs immediately, rather than waiting until 2013 (or possibly even 2014 if the ratification process is delayed). An individual who anticipates that he is at any risk of being investigated by HMRC would therefore be well advised to proceed under the LDF, because if HMRC do commence an investigation before he comes forward, he will lose the opportunity to benefit from either the LDF or the Agreement.

What happens if the Swiss account is closed before 2013?

A taxpayer is not prevented from closing his Swiss accounts before 2013 (although the Swiss bank will not be allowed to help him to do this). He will then not be subject to the Agreement, and it appears that his name will not automatically be given to HMRC. However, the Swiss authorities are required to notify HMRC of the top ten destinations to which funds are moved, and HMRC have indicated that they will target these jurisdictions for future compliance activity.

Conclusion

The Agreement offers a pragmatic way for the UK to tax Swiss accounts held by UK residents while allowing them to continue to enjoy Swiss banking secrecy. However, it is not intended as a full disclosure programme and should not be regarded as such. Although the early publication of the terms of the Agreement is helpful, there is still considerable uncertainty on a number of detailed points and guidance from HMRC on these issues would be welcome. What is clear is that certain actions can be taken already and it is not too early for individuals who will be affected by the Agreement to start considering their options, particularly if they have undisclosed tax liabilities.

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