

NEW INFORMATION AND REPORTING CHALLENGES FOR THE SWISS FINANCIAL SECTOR

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AGENDA

- ❑ U.S. Senate Protocol Hearing, International Tax Administration Organizations, and Exchange of Information Approaches
- ❑ Group Requests Under Swiss Treaty
- ❑ Recent U.S. Enforcement Efforts: DOJ Swiss Program and OVDP
- ❑ Evolution in Reporting Regimes (CRS, G20 and U.K. Crown Agreements)
- ❑ Developments in EU Reporting Regimes
- ❑ U.S. Regulatory Update: FATCA, Harmony and QI

U.S. Senate Protocol Hearing: Confidentiality Concern

- ❑ February 26 Senate Foreign Relations Committee hearing was held in Washington on pending tax treaties with Luxembourg, Switzerland, Hungary, and Chile and proposed protocol to the Multilateral Convention on Mutual Assistance in Tax Matters.
- ❑ Concerns over whether U.S. treaty partners have adequate procedures in place to prevent the misuse of information exchanged under treaty provisions.
- ❑ U.S. Senators objected to their information sharing provisions, which are consistent with the internationally established standard on information exchange.

Concerns Over Confidentiality Issues

- ❑ Assurance that before a country is permitted to become a signatory, an O.E.C.D. coordinating body examines that country's laws and practices to determine whether it would be able to enter into and fulfill its obligations under the Convention.
- ❑ Procedures in place to ensure the confidentiality and appropriate use of information exchanged.
- ❑ Once a country becomes a signatory, it is required to abide the convention's confidentiality rules.
- ❑ Exchanges are closely monitored so that if there is a breach, the I.R.S. will withhold information until issues are resolved.

Concerns Over Confidentiality Issues

- ❑ Only foreseeably relevant or information that may be relevant to an actual, ongoing tax audit or investigation that is being conducted in the foreign country is provided.
- ❑ Request for information will be denied if any indication of a “fishing expedition”
- ❑ In addition to the usual safeguards when negotiating full income tax treaties, before an I.G.A. is entered into under F.A.T.C.A., special procedures are employed to look at the other jurisdictions’ systems, procedures, and policies to be sure that the information will be kept confidential and sanctions will be in place if the confidentiality provisions are violated.

International Tax Administration Organizations

O.E.C.D. – Forum on Tax Administration (F.T.A.)

- ❑ Forum for co-operation between revenue bodies at Commissioner-level with 45 participating countries.
- ❑ Goal is to improve taxpayer services and tax compliance by helping tax administrations increase the efficiency, effectiveness and fairness of tax administration and reduce the costs of compliance.
- ❑ “Tax Administration 2013” published in May, the most comprehensive source of comparative information about tax administration available.
- ❑ Published “Demand Management Guide in 2013”, examination of continuous improvement strategies to tax administration.

Inter-American Center of Tax Administrations (C.I.A.T.)

- Non-profit international public organization that provides specialized technical assistance for the modernization and strengthening of tax administrations.
- Founded in 1967, C.I.A.T. currently has 38 member countries.
- Promote mutual assistance and cooperation among member countries by:
 - Developing specialized technical assistance programs based on the particular needs and interests of member countries, through technical cooperation activities.
 - Encouraging studies and research projects about tax systems and administrations, promoting timely dissemination of relevant information and the exchange of ideas and experiences through general assemblies, technical conferences, seminars, publications and other appropriate means.

International Tax Dialogue (I.T.D.)

- ❑ Collaborative arrangement involving the EC, IDB, IMF, O.E.C.D., World Bank group and C.I.A.T. to encourage and facilitate discussion of matters among national tax officials, international organizations and other key stakeholders.
- ❑ Focuses on international and domestic tax policy and administration issues.

International Tax Dialogue (I.T.D.)

□ Objectives:

- Promote effective international dialogue and networking between international organizations, governments and their officials on tax policy and administration matters.
- Identify and share good practices in taxation.
- Work to identify synergies and avoid duplication of effort in respect of existing activities on tax matters.
- Provide a clearer focus for technical assistance on tax matters.

International Tax Dialogue (I.T.D.)

□ Activities include:

- Contributing to global dialogue on key areas of specific interest, *i.e.*, preparing pilot study "Revenue Administration in Sub-Saharan Africa."
- Enhancing communication and collaboration between the I.T.D. partners through regular liaison and sharing plans, knowledge and insights.
- Five global conferences have been held to date, each attended by senior officials from approximately 90+ countries.

Pacific Association of Tax Administrators (P.A.T.A.)

- ❑ Inter-governmental tax organization.
- ❑ Members include Australia, Canada, Japan, and the United States.
- ❑ Created the Transfer Pricing Documentation Package - members agreed on principles under which taxpayers can prepare one set of documentation that will meet the transfer pricing documentation provisions of each P.A.T.A. member country.
 - Eliminates need to prepare separate documentation for each country.
 - Intended to reduce taxpayer burden and provide certainty that a penalty will not be imposed.
 - Use of Package is voluntary.
 - If the principles are satisfied, will protect the taxpayer from transfer pricing documentation penalties that might otherwise apply in each of the four jurisdictions.

Exchange of Tax Information Approaches

Tax Information Agreements (T.I.E.A.s)

- ❑ Entered into with nations where an income tax treaty is not politically or administratively feasible.
- ❑ Primary interest is to provide law enforcement agencies a mechanism to facilitate investigations of any criminal activity that may have generated income such as drug trafficking and money laundering.
- ❑ Typically do not contain the provisions, which are common in income tax treaties, permitting a requested State to exempt itself from taking measures or disclosing information if such measures or disclosure is contrary to public policy.

Multilateral Convention on Mutual Assistance in Tax Matters

- ❑ Convention revised in 2010
- ❑ Permits non-O.E.C.D./Council of Europe countries become parties to the convention.
- ❑ Provides for all forms of mutual assistance.
- ❑ Among recent signatories that have neither a tax treaty nor a T.I.E.A. with the U.S. are Albania, Andorra, Croatia, Ghana, Nigeria, Saudi Arabia and Singapore.
- ❑ Causes concerns about countries joining who have poor reputations for protecting confidential information.

Income Tax Treaties

- Most U.S. income tax treaties contain an Exchange of Information article.
- Article generally provides for such exchange of information between the competent authorities of the Contracting states as may be necessary for carrying out the provisions of the treaty.

Income Tax Treaties

- ❑ Also provides for the disclosure of information necessary to carry out provisions of the domestic tax laws of each State that are not contrary to the treaty provision
- ❑ Under some treaties, exchanges are allowed only with respect to taxes covered by the treaty generally.
- ❑ Under most treaties, information may be exchanged even if the taxpayer is not a resident of one of the Contracting States.

Income Tax Treaties

- 1994 protocol to the U.S.-Mexico treaty which covers taxes to include those at the Federal level and those taxes imposed at the level of states, counties, cities, and other political subdivisions.
- U.S.-Canada treaty permits disclosure of information obtained under the Exchange of Information article to persons involved in the assessment, collection, administration, enforcement, or appeals of taxes imposed by a political subdivision or local authority of a State that are substantially similar to taxes covered generally by the treaty.

Types of Information Exchange Programs

- Routine Exchange of Information ("Automatic exchange of information"): spontaneous exchange of information not specifically requested by the receiving country.
 - Generally agreed the info will be exchanged on a routine basis.
 - Information the U.S. provides to treaty partners from Forms 1042-S, relating to U.S.-source fixed, or determinable income paid to persons claiming to be residents of the receiving treaty country.

Types of Information Exchange Programs

- Routine Exchange of Information (cont'd):
 - Systematic and periodic transmission of "bulk" taxpayer information by the source country to the residence country.
 - Generally through reporting of the payments by the taxpayer (financial institution, employer, etc).
 - Includes: dividends, interest, royalties, salaries and pensions.
 - May also include: change of residence, purchase or disposition of real property, VAT refunds.

Types of Information Exchange Programs

- Specific Exchange of Information Program ("Exchange of Information upon Request"): involves the coordination of both incoming and outgoing requests for information about specific taxpayers.
 - Info is relevant to an ongoing investigation of a particular tax matter.
 - Most requests result from Examination of a particular tax return, although requests may also arise from Collection Activities or Criminal Investigations.
 - Common problem is that some treaty countries have declined to exchange information in responses to specific requests intended to identify limited classes of persons.

Types of Information Exchange Programs

- Specific Exchange of Information Program (cont'd):
 - Tax returns and return information such as verification of filing status, citizenship, residency, income, expenses and tax liability
 - Third party information return filings
 - Bank records
 - Business records
 - Public records such as deeds, birth, death and marriage records
 - Witness interviews

Types of Information Exchange Programs

- Spontaneous Exchange of Information:
 - Involves the exchange of information that has not been specifically requested, but which in the judgment of the providing Competent Authority, may be indicative of noncompliance with a treaty partner's tax laws and requirements.

Group Requests under Swiss Double Taxation Treaties: Focus on Swiss-US DTT

Tax information exchange on international level: Legal Framework

- Double Taxation Treaties / OECD Tax Model Convention Art. 26: Swiss Reservation
 - Reservation of Switzerland to Art. 26 of OECD Model Convention
 - Restriction of tax information exchange to prevention/prosecution of tax fraud or equivalent offenses

- Withdrawal of Swiss Reservation to Art. 26 of OECD Model Convention on March 13, 2009
 - Re-negotiation of and entering into new tax treaties
 - Exchange of any information being foreseeable relevant for assessment of taxes covered by the respective tax treaty

- Implementation of OECD standard into Swiss law: Tax Administrative Assistance Act (TAAA, entered into force on February 1, 2013)

Tax Administrative Assistance Act: Main Principles

- Administrative assistance is provided exclusively upon request
 - Possibility of group requests
 - Specification of requirements for requests (if not specified in the tax treaty)
- Reasons for non-consideration of requests
 - «fishing expeditions»
 - Request is based on illegally obtained information
- Measures to obtain the requested information
 - Swiss domestic measures for corresponding tax procedure
 - Coercive measures (also with regard to bank information access)
- Legal protection rights
 - Information, participation and appeal rights of persons concerned

Group Requests: OECD Requirements according to updated Art. 26 MTC

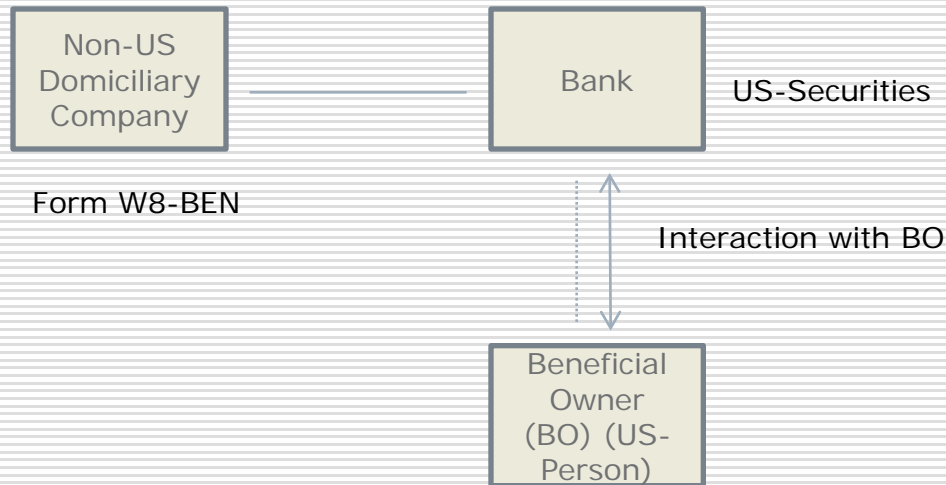
- ❑ Detailed description of the group
- ❑ Detailed description of the facts and circumstances that have led to the request
- ❑ Explanation of the applicable law of the requesting state
- ❑ Explanation of why there is reason to believe that the taxpayers in the group for whom information is requested have been non-compliant with that law
- ❑ Showing that requested information would assist in determining compliance by the taxpayers in the group

Group Requests: Swiss-US DTT 96 Requirements

- Group requests based on case law in case of «tax fraud and the like» (e.g. Federal Administrative Court Decision dated April 5, 2012 regarding a request concerning clients of Credit Suisse, «CS Request»)
- Reasoning:
 - Initial suspicion with regard to fraud and the like
 - Search criterias have been defined in such way that allows to identify the persons who could be accused of fraudulent conduct; the SFTA only had to review the data's suitability with respect to substantiate the initial suspicion
- Principle confirmed in further court decisions

Group Request: Fact Pattern of CS Request, Alternative 1

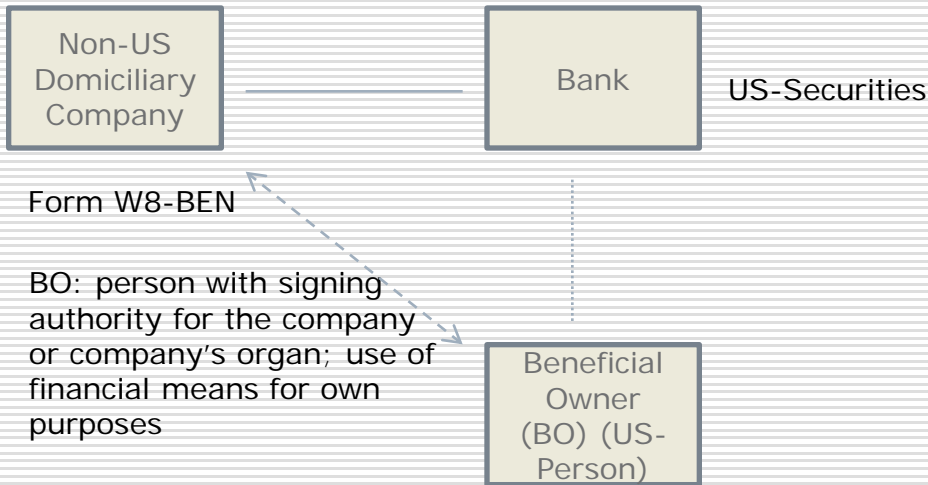
❑ Violation of Corporate Governance



❑ Non-compliance with authority rules

Group Request: Fact Pattern of CS Request, Alternative 2

❑ Violation of Corporate Governance



❑ Use of financial means for own purposes

Group Requests: Swiss-US DTT as amended by the Protocol 2009

- Resolution of Parliament on March 16, 2012 regarding group requests under Art. 26 of the Swiss-US DTT, as amended by the Protocol
 - Allowance of information requests from the U.S. identifying a taxpayers by means of a particular pattern of behaviour
 - Person holding the requested information (e.g. bank) or employees of such person has significantly contributed to the particular behaviour

- No «fishing expeditions»
 - Explanation of relevancy of requested information for tax authority
 - Detailed description of pattern of behaviour and of reasons to believe why the persons concerned have been non-compliant with law
 - Description of non-compliant, active conduct of information holder

DOJ-Swiss Program and U.S. OVDP

Category 1 Banks Under Attack

- **Hearings by the U.S. Senate Subcommittee (February 26, 2014)**
 - The Levin Subcommittee criticized CS for having delivered only 238 out of 22'000 names ("*a minuscule number*") and asks for a UBS-like procedure ("*we want the names*").
 - CS is not to blame for the U.S.' unwillingness to ratify the 2009 Protocol amending the 96 U.S. treaty, thus abolishing the existing "**fraud or the like**" hurdle.

Category 1 Banks Under Attack

- For as long as the “fraud or the like” hurdle exists, CS will not be able to provide any names in simple cases of **tax evasion** (Swiss Federal Court, decision rendered on January 6, 2014).
- The 2010 UBS Agreement allowing UBS to provide names in 4450 cases was subsequently converted into a **treaty override**, which had to be approved by the Swiss parliament with a narrow margin.

DOJ-Program

- **Elements of the Mutual Understanding**
 - A **Joint Statement** entered between the government of the two countries dated August 29, 2013.
 - An **attached** unilateral program (the «**Program**») offered by the DoJ, which allows Swiss banks to settle the past; Swiss banks will have the possibility to pay a fine and obtain either a **Non-Prosecution Agreement (106 Swiss banks opted for Category 2)**, or prove their innocence and obtain a **Non-Target Letter** (Category 3 and 4).

DOJ-Program

- A **Circular Letter** («*Wegleitung zur schweizerischen Musterverfügung*») issued by the Swiss **State Secretariat for International Financial Matters** («SIF») on July 3, 2013 outlining the terms under which Swiss banks are allowed to co-operate in the Program.
- Swiss banks have to ask permission in order to be exempted under Art. 271 Swiss penal Code.

U.S. Taxpayer's Case - OVDP

- The IRS began an open ended OVDP in January 2012. The IRS may end this program at any time in the future.
- VDs have to occur in a “**timely manner**”, i.e., the taxpayer has to approach the IRS **before** the IRS becomes aware of the facts and circumstances of his case.

U.S. Taxpayer's Case - OVDP

- Pursuant to IGA Model 2 non consenting U.S. tax payers may become "**reclacitrant account holders**".
- VD's are a **spot landing**; delinquent U.S. taxpayer should be using competent U.S. lawyers rather than to be talking to the IRS themselves!

FATCA, CRS and UK Agreements with Crown Dependencies and British Overseas Territories

Practical implementation issues (1 of 2)

Described as a "game changer" in international tax co-operation by Secretary-General Angel Gurría is the CRS going to put Financial Institutions on the bench as they prepare to deal with the prospect of automatic exchange of information between a large number of countries in the near future?

For FIs in UK, Crown Dependencies and British Overseas territories this trend has already started with AEOI agreements between these countries going live at the same time as FATCA

Practical implementation issues (2 of 2)

Complexity

- 40 countries have indicated they will be seeking an early implementation of the CRS
- Big bang versus staggered start dates - can FIs build systems which can "switch on" reporting country by country as account holders come into scope?
- How can data protection and banking secrecy issues be addressed if FIs want to collect information on account holders before they are obliged to report that information?
- Definition of residence is complex and varies from country to country. FIs need a consistent standard to apply "reasonableness test" in order to rely on customer's self-certification

Consistency

- CRS provides a "minimum standard" for AEOI and may be amended when implemented between individual countries. This makes it hard for Global FIs with centralised processes.
- EU Commission wants to align the CRS with the European Savings Directive (once it has been extended to cover investment funds, trusts and financial instruments)
- US unlikely to modify FATCA or to offer full reciprocity under AEOI

Leveraging FATCA

- For many FIs the scale of reporting (especially within a single financial market place such as the EU) will be much larger than under FATCA. Therefore tactical solutions (designed to deal with only exceptional reporting under FATCA) will need to be automated
- Timelines are truncated (with reporting potentially starting in 2016 in countries which are early adopters of the CRS). However FATCA systems as yet untested.

Comparison of different regimes: FATCA, UK FATCA and CRS (1 of 3)

- UK FATCA and CRS are heavily based on the FATCA Model 1 IGA and require Financial Institutions to report in respect of Financial Accounts held by residents of the partner jurisdiction (directly or via PNFEEs).
- However there are significant differences between these two regimes and US FATCA.
- Unlike US FATCA compliance with UK FATCA and CRS is not secured under threat of withholding. There is no concept of NPFFIs.
- Under UK FATCA and CRS reporting is mandatory so no potential termination of recalcitrant account holders

Comparison of different regimes: FATCA, UK FATCA and CRS (2 of 3)

	FATCA	UK FATCA	CRS
Registration	✓	✗	✗
Mandatory Compliance	✓ Via FFI Agreement or bilateral IGA and domestic legislation (Model 1 IGA)	✓ Via bilateral IGA and domestic legislation as for Model I IGA	✓ Via bilateral or multilateral IGA and domestic legislation
Due diligence of pre-existing accounts	✓	✓	✓
New account documentation	✓	✓	✓

Comparison of different regimes: FATCA, UK FATCA and CRS (3 of 3)

	FATCA	UK FATCA	CRS
Reporting	✓	✓	✓
Withholding	✓	✗	✗
Termination Of Recalcitrant Accounts (non-IGA countries)	✓	✗	✗

Differences and uncertainties between FATCA and CRS (1 of 3)

- Commentary on the CRS, due to be published by OECD this summer, should resolve uncertainties and (hopefully) minimise differences in interpretation between countries.
- Local guidance would deal with jurisdiction specific issues only?

Differences and uncertainties between FATCA and CRS (2 of 3)

	FATCA	CRS
Due diligence on pre-existing accounts	<ul style="list-style-type: none"> • \$50k de minimis threshold for individual accounts and new depository accounts. • De minimis for entity accounts of \$250k but no review until over \$1 million. • A new account opened for a pre-existing account holder is not treated as a new account. • Phased time line for review of high value and low value accounts • Electronic search for indicia on lower value accounts • Entity classification via internal/publicly available information 	<ul style="list-style-type: none"> • No de minimis for individual accounts (including depository accounts). • De minimis for entity accounts of \$250k. • It is not clear whether a new account opened for an existing account holder will trigger requirement to obtain self-certification. • Time line for review of accounts not specified in CRS. Will it be staggered as for FATCA? • Electronic search or residence test for lower value accounts • Will entity classification be based on same information as FATCA e.g. industry codes??
Documentation of New Accounts	<ul style="list-style-type: none"> • US tax forms or self certification • Revised onboarding procedures for new accounts start from 1 July 2014 • US Controlling Persons of Passive NFFE account holders to be disclosed. 	<ul style="list-style-type: none"> • Bespoke/standard self certification forms? US tax forms not sufficient (even if treaty benefits claimed) as does not allow for multiple residences to be captured. • Cut off date for new accounts may vary depending on country by country agreement. Potentially self-certification may be required immediately the agreement is in effect. However FIs may only want to change onboarding procedures once. • Account holders who are Investment entities in non-reporting countries are treated as Passive NFFEs and any Controlling Persons in a reportable country must be disclosed.

Differences and uncertainties between FATCA and CRS (3 of 3)

	FATCA	CRS
Reporting	<ul style="list-style-type: none"> • FIs exempt from reporting include Local FFIs, sponsored FIs, low value account FIs, certain life insurance business (so called "back book") and LLDIEs. • Reporting of US accounts, pools of non consenting and recalcitrant accounts (Model 2) and NPFFIs • Staggered introduction of reporting on account balances, income and gross proceeds • Products not regarded as financial accounts in Annex II IGA (where low risk of tax evasion by US persons) • Regularly traded debt or equity interest excluded as financial accounts. Limited Life Debt Investment entities excluded from reporting 	<ul style="list-style-type: none"> • FIs exempt from reporting do not include Local FFIs, low-value account FIs or certain life insurance business. No sponsoring concept other than trustee documented trusts. No exemption for LLDIEs • Reporting on multiple residences therefore account balances and income may be reported more than once. Passive NFFEs may be reported in addition to Controlling Persons residence. No reporting of NPFFIs • Start of reporting to be agreed between individual countries. One year delay in start of gross proceed reporting • Annex II exclusions to be negotiated agreement by agreement but likely to be different from FATCA (because of differences in local markets). No exclusion for regularly traded debt or equity interests. • Additional reporting fields for individual accounts include date of birth and multiple tax residencies
Enforcement	<ul style="list-style-type: none"> • For Model 1 IGA Countries local enforcement and penalties. For FIs entering into FFI agreement IRS certification, penalties and potential loss of PFFI status 	<ul style="list-style-type: none"> • Local enforcement only with penalties set by each country.

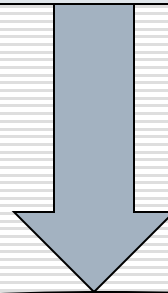
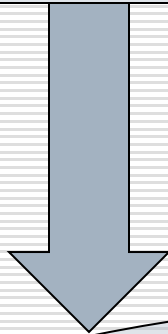
Tax Information Exchange: The EU Perspective

Pillars of EU Policy on Information Exchange

Savings Tax
Directive

Mutual Assistance
Directive

Bilateral agreements
with non-EU countries



common aim:
fighting of tax fraud and tax evasion
by way of information exchange
or withholding at source

Savings Tax Directive (1/5)

- Directive 2003/48/EC
- In force since 1 July 2005
- Instruments
 - automatic information exchange
 - alternatively, some countries apply a withholding tax regime (currently only Austria, initially also Belgium and Luxemburg)

Savings Tax Directive (2/5)

□ Type of income

- interest

- definition of interest includes

- interest accrued or capitalised at the sale, refund or redemption of debt claims

- distributions or sale, refund or redemption of shares in investment funds that invest in debt claims

□ Taxpayers

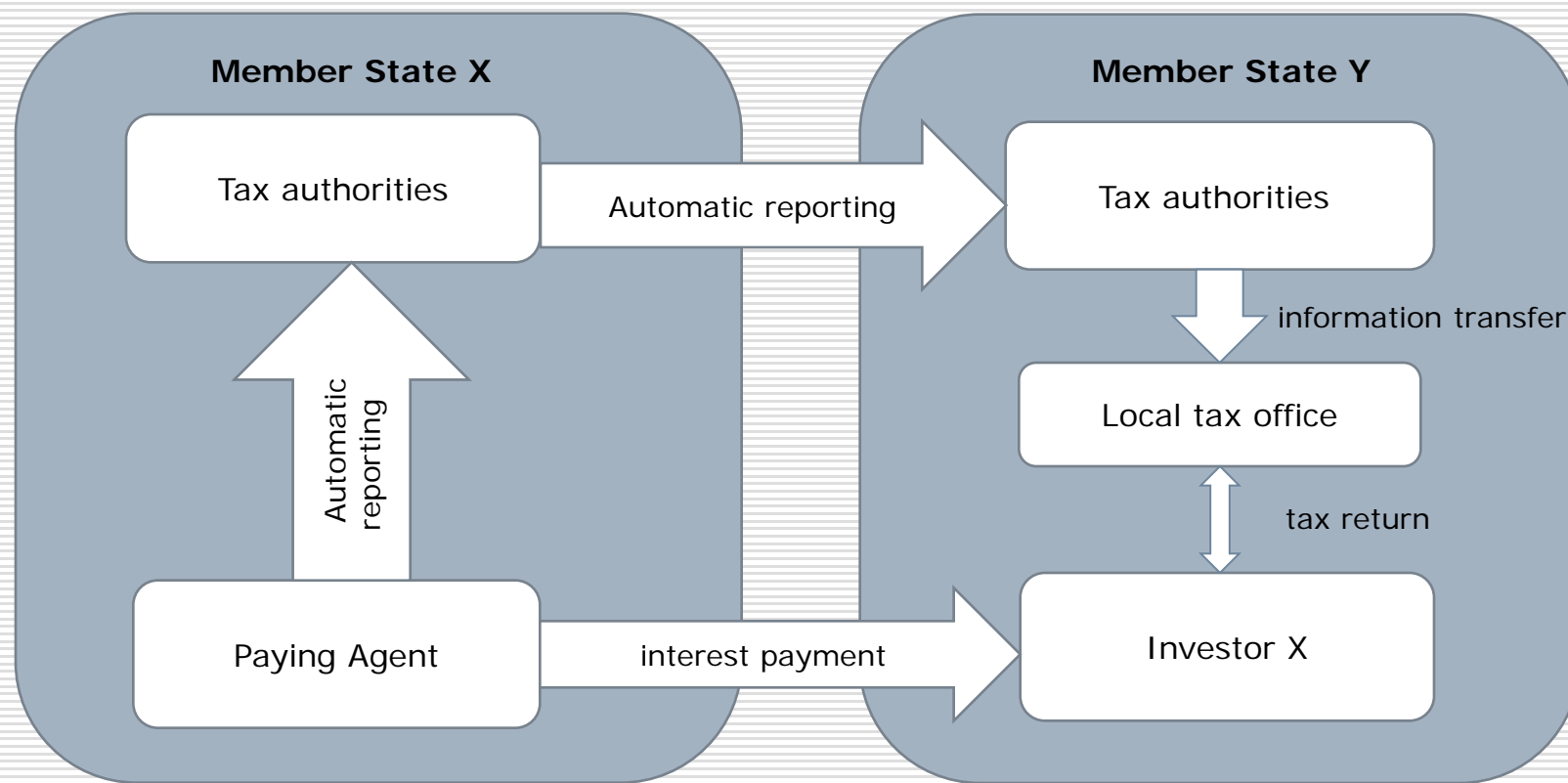
- individuals

Savings Tax Directive (3/5)

- Territorial scope
 - EU member states
 - cross border interest payments within the EU:
 - paying agent established within an EU Member State
 - beneficial owner (individual) resident in another EU Member State

Savings Tax Directive (4/5)

How does the Savings Tax Directive generally work?



Savings Tax Directive (5/5)

- Reform proposal of European Commission (2008)
 - broadening the scope of the Directive to include also
 - legal persons;
 - interest-like income derived from innovative financial instruments
 - distributions of all investment funds that invest in debt claims
 - interest-like income derived from life insurance products

Mutual Assistance Directive (1/3)

- Directive 2011/16/EU
(replaced Directive 77/799/EEC)

- In force since 2013

- Instruments
 - information exchange on request
 - spontaneous (non-systematic) information exchange
 - automatic information exchange (since 2014)

Mutual Assistance Directive (2/3)

<i>Information exchange</i>	automatic	spontaneous	request
<i>Type of taxes</i>	All taxes, <u>except for</u> <ul style="list-style-type: none"> - VAT, - customs duties, - excise duties and - social security contributions 		
<i>Categories of income or capital</i>	<ul style="list-style-type: none"> - employment income - directors fees - life insurance products - pensions - income from real property 	not limited	not limited
<i>Taxpayers</i>	individuals and legal persons		
<i>Territorial scope</i>	EU-member states		

Mutual Assistance Directive (3/3)

- Reform proposal of European Commission (12 June 2013)
 - broadening of scope in line with FATCA such that the following categories of income are included (if paid, secured or held by a financial institution):
 - dividends
 - capital gains on the sale of property
 - other investment income
 - account balances
- and to provide for automatic information exchange in respect of such items

Bilateral agreements (1/2)

□ Bilateral Savings Tax Agreements

- The EC has entered into agreements that provide for measures that are equivalent to those provided for by the Savings Tax Directive with certain third countries.
- Third countries with Bilateral Savings Tax Agreements include:
 - Switzerland;
 - Liechtenstein;
 - Andorra;
 - Monaco;
 - San Marino;
 - some offshore jurisdictions.

Bilateral agreements (2/2)

How does the Bilateral Savings Tax Agreement with Switzerland work?

Example: German-resident individual X receives from a Swiss paying agent an interest payment of € 1,000. Switzerland has opted for the withholding tax regime (in lieu of an automatic information exchange).

gross interest	1,000.00 €
withholding tax (35%) to be withheld by paying agent	-350.00 €
net interest paid to investor X	650.00 €
withholding tax paid by paying agent to Swiss tax authorities	350.00 €
revenue sharing:	
revenue forwarded by Swiss taxman to German taxman (75%)	262,50 €
revenue retained by Swiss taxman (75%)	87,50 €

Synopsis of current and proposed acts

<i>Directive / agreement</i>	Savings Tax Directive	Reform proposal	Mutual Assistance Directive	Reform proposal	Swiss Bilateral Tax Savings Agreement
<i>automatic exchange</i>	yes	yes	yes	yes	no (withholding)
<i>scope of information exchange</i>	interest	other interest-like income	<ul style="list-style-type: none"> - employment income - life insurance products - pensions - income from real property 	<ul style="list-style-type: none"> - dividends - capital gains - other investment income - account balances 	interest
<i>taxpayers</i>	individuals	individuals and legal persons	individuals and legal persons		individuals
<i>territorial scope</i>	cross-border within the EU		cross-border within the EU		<ul style="list-style-type: none"> - Swiss paying agent - EU beneficiary owner

Recent Developments (1/2)

- May 2013: ECOFIN granted European Commission negotiation mandate for revision of Bilateral Savings Tax Agreement with Switzerland.
- June 2013: Commissioner for Taxation, Algirdas Semeta, announced a reform (i.e., broadening of the scope) of Mutual Assistance Directive.

Recent Developments (2/2)

- ❑ December 2013: Swiss Federal Council granted negotiation mandate for revision of Bilateral Savings Tax Agreement.
- ❑ January 2014: Beginning of negotiations between EU and Switzerland.
- ❑ Towards the EU, Switzerland so far has refused to enter into an agreement providing for an automatic information exchange.

Impact of EU initiatives on Switzerland

- Savings Tax Directive
 - not directly applicable
 - Bilateral Savings Tax Agreement (withholding regime)
 - negotiations on revision of Bilateral Savings Tax Agreement have just started
- Mutual Assistance Directive
 - no bilateral agreement yet
 - Switzerland wants to discuss any regime providing for an automatic exchange of information only within the OECD

RECENT U.S. LEGAL DEVELOPMENTS OF INTEREST TO THE SWISS FINANCIAL SECTOR

What Happened on February 20, 2014?

- U.S. Treasury/IRS published two sets of regulations (565 pages!)
 - Modifications of FATCA regulations; and
 - “Harmonization of the FATCA rules with the existing “NRA” chapter 3 rules and the U.S. domestic backup withholding regime.
- BUT: Important Guidance Remains Outstanding
 - Updated Qualified Intermediary Agreement (“QIA”)
 - Qualified Securities Lender (“QSL”) Rules
 - Final FFI Agreement (updated version expected).

FATCA MODIFICATIONS: OVERVIEW

- Unlike the proposed and final FATCA regulations which ushered in sweeping and challenging rule changes with significant operational impact, the recent set of FATCA regulations are refreshingly anticlimatic (with a few notable exceptions):
 - Many technical fixes and clarifications;
 - “Regification” of rules previously announced (e.g., Notice 2013-69);
 - Rules for fairly specialized constituencies left out of original rules.
- Why are the regulations issued in “temporary and final form”?
 - The need to provide guidance that withholding agents can immediately rely on given the July 1 FATCA effective date.
 - Allow room for comment from the industry and further tweaking of rules if needed.
- **NO CHANGE IN JULY 1 EFFECTIVE DATE!!!**

Some Key FATCA Modifications

- **Expansion of EAG Qualification:**
 - Prior rule – all FFI members of an EAG must be participating FFIs or registered deemed-compliant FFIs.
 - Regulations now allow exempt beneficial owners and certified deemed-compliant FFIs.
 - Does this mean that non-registering local banks, FFIs with low value accounts, and sponsored closely held investment vehicles can belong to an EAG?
- **Limited Life Debt Investment Entities (“LLDIE”)**
 - Original rules were too restrictive.
 - Regulations substantially liberalize criteria in response to widespread industry comments.
- **Payments on Collateral Not Subject to Withholding Until 2017**
 - Affects collateral associated with derivatives, security loans, repos, and money loans.
 - Prior rules had differences between offshore and on-shore collateral and grandfathered and non-grandfathered collateral and instruments.
 - New clean rule simply excuses any withholding on collateral payments until 2017.
 - Idea is to provide time for withholding agents to adopt system changes to effectuate a more nuanced withholding policy for pooled collateral.

Some Key FATCA Modifications (Cont'd)

- ❑ **Grandfathered Obligations:**
 - New rules require “actual knowledge” of a material change that would “substantially modify” an grandfathered obligation and treat it as no longer grandfathered.
 - Questions remain as to when one has “actual knowledge” and how operationally this rule can be made to work to minimize any FATCA under withholding exposure.
- ❑ **Pre-existing Account Documentation Sharing Not Limited to Consolidated Obligations:** In addition to consolidated obligations on qualifying systems, can share if accounts are in the same EAG and all parties have obtained/reviewed copies and the documentation is valid/reliable.
- ❑ **Substitute Forms W-8 For Individuals:** The regulations remove the requirement that these substitutes must collect the city of birth in favor of date of birth even if foreign TIN provided.
 - Potential change pending for final “official” Form W-8BEN??

Some Key FATCA Modifications (Cont'd)

- **Significant Change In Treatment of Grantor Trusts!**
 - Prior rule: grantor and not trust = account holder.
 - New rule: grantor trust is the account holder (that is, there is an “intermediary” trust that must be documented for FATCA status as it is for Chapter 3).
 - Unclear how IRS expects any U.S. beneficiaries of an NFFE grantor trust to be disclosed – perhaps a change to the Form W-8IMY?
 - FFI grantor trusts (i.e., due to breadth of investment entity definition) will need to disclose U.S. beneficiaries regardless of interest in trust.

- **Direct Reporting NFFEs**
 - NFFEs that register with IRS and report any substantial U.S. owners directly to IRS and not to another withholding agent.
 - These arrangements were apparently requested by the insurance industry but apply more broadly.
 - Many questions remain – particularly how compliance will work.

Some Key FATCA Modifications (Cont'd)

□ **Reduction in Number of NPFFIs and Recalcitrants:**

- Under original rule, failure to reduce these populations was an event of default under the FFI Agreement.
- The rules now provide that the default “only” arises if the withholding agent negligently fails to follow the rules and either does not collect documentation or apply the presumption rules appropriately.

□ **Group Treasury Entities**

- Known as “excepted inter-affiliate FFIs.”
- They can now have bank accounts if in the same country as the FFI’s operations and used to pay expenses in that country.
- May only receive bank deposit interest.

The New Chapter 3 Regulations: General

- The “harmonization” of the chapter 3 rules with FATCA has substantially changed the rules for reducing U.S. taxation at source on U.S. source income payments that have been in place since 2001.
 - All U.S. payors, including QIs, NQIs and USFIs, are strongly affected.
 - Substantial changes to systems and procedures for the following will be necessary: due diligence; document collection, validation and maintenance; withholding; and reporting.
- Rules are “effective” when published in the Federal Register but do not take effect until July 1 to correspond with FATCA changes.
 - Additional transitional relief possible??
 - That is, to allow for chapter 3 changes to occur – not for FATCA effective date to be pushed back.

Importation of FATCA Rules into Section 1441 Regulations

- Transformation: Anyone familiar with the section 1441 regulations will find them substantially transformed by the importation of many rules from the FATCA regulations so that they also apply for “chapter 3” purposes, including:
 - **U.S. Indicia/Reason To Know/Associated Cures:** Be aware of new U.S. indicia that are relevant for chapter 3 claims such as telephone numbers and the use of FATCA-type cures if U.S. indicia identified.
 - **Presumption Rules**
 - **Document Maintenance:** Electronic means sanctioned.
 - **Substitute Form Standards:** NOTE: non-English languages can be used but Forms W-8 **MUST BE** used for chapter 3 – no self-certifications.
 - **Use of Coordinated Account Systems:** BUT NOT third-party data provider use.
 - **Mergers and Bulk Transfers:** These rules allow transitional relief when acquiring forms from other parties – a longstanding problem in chapter 3 audits.

The Underbrush

- The FATCA rules announced many welcomed changes to address chronic disputes with the IRS over administratively insignificant issues, and the following are now good for Chapter 3:
 - **Electronically Sent Forms W-8/Documentary Evidence (e.g. Faxes and PDFs):** These are good as long as the recipient does not have actual knowledge that the sender did not have authority to send the form.
 - Copies?? So is a faxed copy ok but a "xerox" is not??
 - **Signature Authority:** Who will miss arguing about whether a "director" is an officer able to sign or whether an "authorized signer" is acceptable?
 - **Checklists to Solicit Reasonable Explanations:** Using the "reasonable explanation" list from the FATCA regulations.
 - **The Effect of Footfaults:** No more arguing about abbreviations like the U.K.!
 - **Addresses at Financial Institutions:** Funds finally get a recognized home.

New Standards On Curative Documentation

- The problem of how to cure late collected documentation can be an issue for withholding agents of all stripes (non-U.S. with U.S. operations; QIs; NQIs supplying documentation to U.S. withholding agents)
- **Late Collected Documentation Cures**
 - **Same as FATCA Rules:** The section 1441 regulations now contain the same rules as the FATCA regulations for curing late collected documentation.
 - **Affidavits of Unchanged Status:** Now an accepted approach.
 - **Additional Documentation:** However, the IRS may require additional documentation in addition to a W-8 and the affidavit to prove a prior payee status.
 - This could be a serious administrative headache and with little apparent benefit to the IRS other than the punitive effect on the withholding agent.

Evergreen Forms W-8

- The new section 1441 regulations follow the FATCA rules on the extended validity of Forms W-8 (such that they do not have to be renewed every three years) with one important exception:
 - **Forms for Treaty Claims:** MUST be renewed every three years.
- **DO NOT FORGET OTHER EXCEPTIONS FROM EVERGREEN STATUS THAT ALSO APPLY FOR FATCA:** Serious withholding tax exposure can result ...:
 - **Change in circumstances:** (relevant to the claim being made)
 - **U.S. Indicia Present**
 - **Forms Received From Intermediaries:** That is, your U.S. withholding agent will be asking you for forms every three years.
 - **Forms W-8ECI**

Some Chapter 3 and 4 Differences

- ❑ **Priority Rule:** The new section 1441 regulations specify that FATCA withholding and presumption rules are applied before chapter 3 rules.
- ❑ **Grace Rules:** Chapter 3 has **NO** grace period before withholding kicks in on a change in circumstances, as opposed to the 90-day period for FATCA.
- ❑ **Exempt Income Types:** What is exempt for chapter 3 (e.g., security sale proceeds, portfolio interest, etc.) is not for FATCA. And what is exempt for FATCA (e.g., grandfathered obligations) is not for chapter 3. Security master systems must be coded accordingly.

Extensive Changes to NQI Rules

- ❑ **Non-qualified Intermediaries Defined:** These are simply FFIs that have not entered into a QIA with the IRS and may be either good or bad FFIs for FATCA.
- ❑ **Obligation to Disclose U.S. Non-Exempts:** Local law restrictions are no excuse.
- ❑ **Documentation Must be Supplied for Chapter 3 Reductions:** NQIs must provide to their U.S. withholding agent a valid Form W-8IMY, withholding and allocation statement (updated as necessary), and underlying beneficial owner documentation.
 - **Electronic Statement:** The withholding and allocation statement can be electronic and logistical details are largely left to withholding agents to work out.
- ❑ **Chapter 4 Status of Downstream Intermediaries:** The withholding statement must provide the chapter 4 status **and** **GIIN** of each non-U.S. intermediary and flow through that receives a payment from the NQI.
 - **Effect on IGA FFIs?** This may present complication for FFIs in IGA countries.

Extensive Changes to NQI Rules (Cont'd)

- **Some Dispensation for PFFIs and RDCFFIs:** Their withholding statements can use chapter 4 withholding rate pools for payments to NPFFIs and recalcitrants.
- **New Alternative Procedure:** This procedure allows documentation to be supplied after a payment and has special pooling conventions.
 - **Allocation Information:** Must be supplied by January 31 of following year or extensive penalties apply.
 - **Unintended Default Approach?** The lack of pooling for “normal” NQI withholding statements may lead to the more widespread use of the alternative procedure to reduce operational complexities.

Forms 1042 and 1042-S

□ Form 1042 Tax Returns

- Aggregate chapter 3 and 4 information can be reported.
- However, a “payments and withholding reconciliation” similar to statement 18 of the QI external audit report is now required.

□ Form 1042-S

- Reporting systems must include new FATCA codes.
- Reporting of any new “pools” that have been added for QIs and NQIs.
- **Transitional Rule for 2014:** More than one type of income may be included on the recipient copy to allow additional time for withholding agents to adjust their systems.

QI Changes -- General

□ What is Missing Still??

- Updated QI Agreement!
- Some final forms and instructions (Forms W-8BENE and IMY).

□ Who Can Be a QI?

- **PFFIs, RDCFFIs, M1 and M2 Reporting FFIs**
- **Foreign branch of USFI**
- **NFFE:** They will be treated as excepted NFFEs
- **Limited QIs:** These are allowed until December 31, 2015, although hard to see how they would stay in business given the withholding.

□ All or Nothing on U.S. Accounts

- **Designated Accounts:** Traditionally QIs only had to act as a QI with respect to the accounts that it designated with a U.S. withholding agent.
- **Not for U.S. Non-Exempts:** Any FI serving as a QI **MUST** report all U.S. accounts.

QI Compliance

□ No More QI External Audits?

- **FFI Certification Approach:** Section 1441 regulations appear to envision replacing the QI external audits with some sort of FFI-style certification approach.
- **Additional Information Required?** It is unclear if information in addition to the certifications will also have to be supplied and how burdensome – or legally challenging – this will be.
- **External Audit Waivers:** The fate of the current waiver approach is up in the air and may well be tied into the above two points.
- **Real Relief?** Will QIs really be able to reduce their current compliance efforts in light of the new approach?

QIs and DOJ Swiss Program

- In late March, DOJ publicly announced that technical compliance with a QIA will not insulate a Swiss FI from potential criminal prosecution, if Swiss FI:
 - Moved U.S. customers into non-U.S. source investments to avoid inclusion in QI; or,
 - Otherwise used QI requirements to hide the identity of U.S. customers (perhaps by moving U.S. customers into domiciliary companies and documenting them as “foreign” with Forms W-8BEN).

QI Withholding Statements

- ❑ **Extensive Changes to QI Withholding Statement**
 - **Designation of QI Accounts**
 - ❑ All or Nothing on Withholding: If the QI elects to be withheld upon for FATCA then it the same applies for chapter 3.
 - ❑ QSL Status: QSL status for an account can be designated.
 - **New Pools**
 - ❑ Chapter 4 withholding rate pool of U.S. payees;
 - ❑ 28% pool for undocumented U.S. non-exempts (this is an alternative procedure);
 - ❑ “Fused” pools for chapter 3 and 4 purposes;
 - ❑ Nonparticipating FFI and Recalcitrant Pools

Thank You!

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