

EUROPEANCEO magazine, (March 17, 2011)

<http://www.europeanceo.com/business-and-management/the-secret-vaults>

The secret vaults

Switzerland has long been a safe haven for rich business people to deposit their vast sums of money and only once before have their methods been brought into question. Now however, as the world struggles for capital, all eyes are back on Switzerland in a pursuit for our missing millions



That Switzerland's banking secrecy laws have been subject to systematic legal, moral and economic attack over the last couple of years is an argument many objective observers would find difficult to counter. Whilst the methodology used to chip away at the privacy veneer has been different in the post credit crunch world – with fellow Western governments putting pressure on the Swiss authorities as they seek to retrieve capital they believe to have escaped their own tax nets – the end result has been much the same.

The narrative in many ways though begins back in 1995 when the then President of the World Jewish Congress (WJC), Edgar M. Bronfman, met Swiss bankers in Bern to discuss the fate of Jewish accounts, hitherto unclaimed, following the Nazi genocide of World War II. At that meeting Bronfman was left clicking his heels in a sparse room for 10 minutes before a number of bankers came and began to dictate terms. They came up with a figure of 774 dormant accounts worth \$32m but with the implication, for Bronfman at least, that they were attempting to buy him off with what appeared to be a final settlement.

Slighting the Seagram's liquor magnate, whether intended or not, would ultimately prove to be a defining moment as Bronfman and the WJC subsequently elicited political support in the US from sympathetic 'movers and shakers' such as the Republican senator from New York, Alfonse D'Amato and President Bill Clinton.

As head of the US Senate Banking Committee D'Amato was in a position to offer its services to Bronfman. Clinton meanwhile tasked Under-Secretary Stuart Eizenstat to investigate the issue of Nazi gold offloaded to Switzerland.

Senate hearings, which began in April 1996, soon outlined a number of allegations, including the claim that hundreds of millions of dollars of war-era Jewish assets remained in Swiss banks. Equally serious was the subsequent claim by whistleblower Christoph Meili, who served as a night guard at the then Union Bank of Switzerland (prior to its re-branding as UBS after its merger in 1998 with Swiss Bank Corporation) had discovered that selected officials had been destroying documents pertaining to 'orphaned assets', i.e. credit balances of deceased Jewish clients whose heirs' whereabouts were unknown.

As the evidence accumulated a number of class action lawsuits were filed in late 1996, early 1997 in several US federal courts against certain Swiss banks and other Swiss entities, alleging Swiss financial institutions had collaborated with and aided the Nazi regime by

knowingly retaining and concealing assets of Holocaust victims, and by accepting and laundering illegally obtained Nazi loot and the profits of slave labour.

All the cases were eventually consolidated before Judge Edward R. Korman, of the US District Court for the Eastern District of New York. During the course of these lawsuits — and as the parties commenced settlement discussions — two commissions were established to explore Switzerland's role during the Nazi era. The first was the Independent Committee of Eminent Persons (ICEP) – also known as the Volcker Committee (after former Fed Chairman, Paul Volcker) – which was set up on May 2, 1996 as the result of an agreement between the Swiss Bankers' Association (SBA), the World Jewish Restitution Organization and the WJC.

The second, the Bergier Commission, was established on December 13, 1996 – the Swiss Parliament, having passed a decree mandating a committee of experts to determine the scale and scope of money flowing into Switzerland from Nazi Germany. The Volcker Committee's two main objectives were to 'identify accounts in Swiss banks of victims of Nazi persecution that have lain dormant since World War II or have otherwise not been made available to those victims or their heirs' and 'to assess the treatment of the accounts of victims of Nazi persecution by Swiss banks.'

In its final report, issued on December 6, 1999, the Committee determined that of the 4.1 million bank accounts opened in Switzerland before and during WWII, for which records still existed, 53,388 accounts (of the approximately 300,000 accounts audited) could be identified as 'probably' or 'possibly' related to victims of Nazi persecution. Some 6.85 million accounts had been opened between 1933 and 1945. To arrive at these numbers, auditors trawled through the records of the 59 banks representing the 254 establishments in operation in Switzerland in 1945. The accounts were then put in a so-called Accounts History Database (AHD).

Further analysis by the Committee, the auditors and the banks themselves, resulted in the 53,388 figure being reduced to roughly 36,000. Meanwhile, the number of accounts whose details were to be published – and agreed to by the SBA 11 months later – was subsequently cut to 21,000 from the original 25,000 of AHD accounts recommended by Volcker. It concluded the value of the AHD was approximately \$643m to \$1.36 billion, including interest.

UBS and Credit Suisse meanwhile had agreed to open their archives for auditors to examine two million Nazi-era accounts. On January 26, 1999 a formal agreement was signed by all parties, settling the lawsuits for \$1.25bn, after months of negotiations following an agreement reached in principle in August 1998. By June 2010, \$1.09bn of the \$1.25bn had been distributed or allocated to 452,000 members of five different settlement classes.

In exchange for settlement the plaintiffs and class members agreed to release and forever discharge Swiss banks, the Swiss government and other Swiss entities from, any and all claims relating to the Holocaust, World War II, and its prelude and aftermath. Bronfman for his part, resigned from his post in 2007, following months of political turmoil that had seen the ouster of secretary general, Israel Singer, over allegations of financial improprieties.

While the issue of Nazi-era complicity had finally been put to bed – a second front was eventually opened – this time with the Internal Revenue Service (IRS) in the US formally launching an investigation into the activities of UBS.

That probe began in June 2008 after Bradley Birkenfeld – a banker at UBS – pleaded guilty to conspiracy and claimed the bank had helped wealthy US clients evade income tax laws and hide assets worth \$20bn. In February 2009 UBS was fined \$780m – unsealed court documents at the time showing that in 2000, as part of its purchase of US brokerage firm Paine Webber, the bank had entered into a voluntary agreement with the IRS to report income and other identifying information regarding US clients holding US securities in UBS accounts. The agreement also required the bank to withhold income taxes from US clients directing foreign investment activities from within the US.

The documents also alleged that between 2000 and 2007 selected employees in the bank's cross-border business, with the knowledge of certain executives, helped US taxpayers set-up new accounts where they would not be identified as beneficiaries.

It was further alleged that UBS managers and employees used encrypted laptops and employed other counter-surveillance techniques to help prevent the detection of the identities and offshore assets of their US clients. Clients of the cross-border business reportedly in turn filed false tax returns, which omitted the income earned on their Swiss bank accounts and failed to disclose the existence of those accounts to the IRS.

The clue to the US government's future stance regarding Switzerland's banking secrecy laws could be seen in the statement issued at the time by Acting Assistant Attorney General of the Justice Department's Tax division, John A. DiCicco: "Today's agreement is but one milestone in an ongoing law enforcement effort to reassure hard-working and law-abiding taxpayers who pay their fair share of taxes that those who don't will pay a heavy price.

"The veil of secrecy has been pulled aside and we will continue to aggressively pursue those who shirk their federal tax obligations or assist others in doing so."

No sooner was the ink dry on this particular settlement than the US authorities claimed the Swiss government had failed to provide records on as many as 52,000 US tax cheats holding secret Swiss accounts. As a result the US Department of Justice filed suit in a Florida federal court seeking enforcement of a 2008 Internal Revenue Service "John Doe" summons for the names of all Americans with "undisclosed" accounts at UBS.

The bank eventually reached agreement with the authorities in August 2009 to supply details on 4,450 secret accounts held by US clients. By November 2010, when US authorities indicated they would formally drop their investigation, they confirmed that approximately 4,000 cases had been supplied to the US to date. The deal had very nearly been scuppered in January 2010 though when a Swiss court ruled it wasn't enforceable under existing Swiss legal provisions. Lawmakers subsequently resuscitated it in June 2010.

IRS Commissioner Douglas Shulman noted the agency's investigations had prompted voluntary disclosures by 18,000 Americans, including thousands with accounts at other banks. This included 3,000 individuals who had come forward despite the expiry, 12 months earlier, of an official programme to provide 'some leniency' for disclosure.

While there is little doubt the squeeze placed on UBS was symptomatic of a much larger fishing expedition on the part of the US authorities – the voluntary compliance numbers bearing testimony to that – it also reconfirmed the systematic attack on Switzerland's bank secrecy laws.

Stung by their run in with the US legal authorities, coupled with more general pressure being placed on tax havens in the post credit-crunch world, the Swiss authorities have progressively come in from the cold over the last 18 months – much of the 'incentive' being provided by the G-20 nations after they decided in April 2009 to place Switzerland on a so-called "grey list" of tax havens. Threatened sanctions, should Switzerland not adopt OECD standards regarding assistance in tracking down tax cheats, was always going to be a sufficient reality check.

Indeed, by September 2009, Switzerland was removed from the list after bank secrecy laws were relaxed and a number of new double-taxation agreements were signed with other countries. In the interim, Switzerland has entered into talks with Germany and the UK on landmark tax treaties whereby Bern would collect a withholding tax on undeclared bank accounts held by Germans and Britons and send the money back to Berlin and London. In return, the identity of the accounts would remain secret. Bern is still finalising the details of these treaties.

As James Nason, international spokesman for the Swiss Bankers' Association (SBA) puts it: "The Swiss believe that withholding taxes are a very effective and efficient method of encouraging taxpayer honesty and discouraging tax evasion, and the Swiss have over 60 years' practical experience with them.

“The SBA is currently advocating a final withholding tax model to ensure that any investment income received in Switzerland by foreign taxpayers (priority is on EU member states) is subject to effective taxation. This final withholding tax model would go much further than the EU’s Taxation of Savings Income Directive which is focused only on interest-earning products and which is thereby riddled with loopholes.”

For Nason though, the threat of so-called regulatory arbitrage is a very real one, arguing that while international agreement in many areas was reached after the financial crisis, national regulators still have considerable leeway with regard to details and timetables.

“Banks could shave millions off their cost base simply by fleeing to jurisdictions with more relaxed regulators. This is why the SBA is placing so much importance on achieving an international level playing-field. Excessive regulation in Switzerland that goes far beyond international norms threatens to place Switzerland’s globally-active banks at a serious international competitive disadvantage.”

Dr Franco Taisch, professor for business law and managing director of the Institute of Business Law in Lucerne, picks up this point, arguing that the speed with which people move their money out of countries joining the fight against criminal tax activities, if at all on a big scale, will depend on how quickly other states alter their own tax legislation. When it comes to changing value systems, ‘the world is not standing still, but hopefully it will be in a balanced way,’ he says.

In February 2011, meanwhile, the Swiss Finance Ministry confirmed the threshold, regarding the amount of information foreign tax authorities investigating tax cheats had to submit, was now being lowered. Previously, the Swiss had demanded full bank-account details plus the name and address of the individual concerned.

Now, Switzerland will have to provide information on bank account holders if foreign authorities simply provide an account number, or similar details, such as a social security or credit card number.

Foreign governments looking to use the less stringent laws as an excuse for further fishing expeditions are likely to be disappointed however as the Swiss Federal Tax Administration will likely still insist on a foreign government providing suitable background information as to why a specific person is on their radar. In short, the Swiss regulatory dog isn’t ready quite yet to roll over and have its stomach tickled.