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Regularization of undisclosed assets in Switzerland and South Africa – Transparency on the horizon

Introduction

The Organization for Economic Co-operation and Development ("OECD") Standard for Automatic Exchange of Financial Account Information in Tax Matters, which encompasses the Common Reporting Standards ("CRS"), is designed to be a single global standard for the automatic exchange of financial account information aimed at combatting offshore tax evasion and tax non-compliance.

Developments in Switzerland and South Africa

South Africa and Switzerland are amongst the many jurisdictions, which have committed themselves to implement the CRS. South Africa is one of the early adopters of the CRS and is committed to commence exchange of information from 2017.

Switzerland will exchange information from 2018, meaning that Swiss banks will be obliged to commence compiling financial information about the captured accounts as from the beginning of 2017. The Swiss Parliament has put in place all of the necessary legislation for the Swiss Federal Tax Administration to be ready to provide the sought information as from the beginning of 2018.

On November 24, 2016, the Swiss ambassador to South Africa and the South African Finance Minister signed a joint declaration expressing their intention to introduce the automatic exchange of information ("AEOI") in tax matters in 2018 and to exchange such information as from 2019 onwards.

Switzerland has already entered into agreements and joint declarations regarding CRS with the European Union and states such as Australia, Canada, Norway, Japan, Jersey and Guernsey and is expected to commit to exchange information with various other countries. These agreements and declarations are made with reservation of the respective agreements and laws being signed and in force and with the following criteria: sufficient confidentiality and data protection provisions, information on implementation of CRS in the respective country, appropriate rules on voluntary disclosure and strengthening of cooperation in the area of financial services.

The joint declaration with South Africa is a strong indication that Switzerland is convinced of South Africa's strong adherence to the principle of speciality and the safeguarding of confidentiality of the data delivered, both of which are prerequisites for the introduction of AEOI.

Double Taxation Agreement South Africa - Switzerland

In addition to the implementation of AEOI, it should be noted that there exists a double taxation agreement ("DTA") between South Africa and Switzerland enabling the countries to exchange information on request in cases of tax fraud. A request has to include, inter alia, the identity of the person concerned and a description of the information requested. If the request is granted and no appeal is lodged, the documents identified in the final order of the Swiss Federal Tax Administration ("SFTA") are transferred to the requesting authority.

As from 2019 onwards, South African and Swiss tax authorities will be able to receive account foreign account information directly from each other without having to go the route of administrative assistance requests, which are frequently burdensome and their outcome legally uncertain. Until such time, requests based on the DTA will remain the only option for the tax authorities of the two countries to access overseas account information.

Regularization of assets by South African taxpayers

South Africa plays a leading role in the global movement towards greater transparency and exchange on information in tax matters to ensure international tax compliance. South African taxpayers who have not yet regularized their position with respect to their offshore assets should, therefore, be reminded that the South African Revenue Service ("SARS") currently offers a Voluntary Disclosure Programme ("current VDP") for such purpose and recently announced a Special Voluntary Disclosure Programme ("Special VDP") which will apply for a limited window period which commenced on 1 October 2016.

Switzerland too is leading the way with regard to transparency. The Swiss government has committed itself to promoting a strategy of legitimate money ("Weissgeldstrategie") in the sense that it is making significant efforts to ensure tax conformity and prevent any misuse in connection with the banking secrecy. Switzerland's intention is to maintain its high reputation as a leading financial centre and is a role model with regard to transparency in the financial world. Regularization also plays an important role (see below).

Global system of automatic exchange of information according to South African Regulations

The Minister of Finance published regulations in terms of paragraph (a) of the definition of “international tax standard” in section 1 and under section 257 of the Tax Administration Act No. 28 of 2011 (the "TAA"), in respect of the changes to the CRS in order to give effect to same in South Africa ("Regulations"). In terms of the Regulations, South African Financial Institutions are obliged to report to SARS on all foreign-resident account holders and controlling persons’ account details irrespective of whether South Africa has concluded a DTA with their jurisdiction of residence or whether the jurisdiction is a CRS participating jurisdiction.

The relevant information that will be provided by South African Financial Institutions include, inter alia, the interest and dividends received, the account balance or value, income from certain insurance products, sales proceeds from financial assets and other income generated with respect to assets held in the account or payments made with respect to the account of the individual or entity concerned.

South Africa has also previously introduced law, known as the Financial Intelligence Centre Act No.38 of 2001 ("FICA") to combat money laundering. In terms of the FICA, all accountable institutions are required to ensure that they have correct details for all their customers by complying with the Know Your Customer ("KYC") requirements. The improved KYC and beneficial ownership requirements proposed in the Financial Intelligence Centre Bill, 2015, should assist in underpinning the CRS and other exchange of information initiatives since the Financial Intelligence Centre will receive reports of suspicious activity in relation to potential tax evasion, as well as money laundering and other criminal offences.

The South African Reserve Bank ("SARB") further monitors cross-border flows, with some transactions requiring specific approvals through Authorized Dealers. This should also assist in underpinning the CRS and other exchange of information initiatives.

The DTA between South Africa and Switzerland and Administrative Assistance in Tax Matters

As already mentioned, the current DTA between South Africa and Switzerland, which will continue to govern the bilateral relations between the two countries until the coming into effect of the AEOI in 2019, does not provide for an automatic exchange of information. Further, the DTA is not based on the current OECD Model Agreement. This means that exchange of information on request is possible, but only in cases of tax fraud. The latter is a fraudulent conduct, which constitutes a tax offence, which in both South Africa and Switzerland, can be punished with imprisonment.

In Switzerland, there are currently several court cases pending with regard to an administrative assistance request in the form of a so-called "group request". A group request is a request based on a treaty, which focuses on a group of persons and not an individual person as such. The criteria for identifying the persons to which the group request shall apply are formulated along general criteria and do not contain personal identifiers such as names or bank account details. In the present cases, the issue of unreasoned "fishing expeditions" by foreign tax authorities came to the fore.

Procedurally, a person affected by a group requests may do the following: After the person concerned is informed by its bank about the request, this person can either designate a representative or a current address in Switzerland. The representative can ask for access to the file and it is also possible to file a statement to the SFTA (e.g. arguing why administrative assistance should not be granted or simply limited to certain documents). Subsequently, the SFTA issues its final order. An appeal to the Swiss Federal Administrative Court against such order must be filed within 30 days. Until the rendering of the decision of the court, no data is submitted to the foreign tax authority. The decision of the Swiss Federal Administrative Court can only be appealed in very limited cases.

New development in Switzerland

As noted above, Switzerland has seen a sharp rise in group requests from overseas tax authorities. One category of cases concerned Dutch residents with undeclared assets at a Swiss bank. Different from

Switzerland and South Africa, Switzerland and the Netherlands have a DTA based on the OECD Model Agreement in place. The Swiss Federal Tribunal, the country's highest court, has recently decided that such generic group request, as issued by the Dutch "Belastingsdienst" (tax authority) in the Dutch cases, are admissible. In the Dutch cases, the tax authority in the Netherlands only knew that Dutch clients of a certain Swiss bank had during a certain period of time received letters by the bank asking them to confirm their tax compliance. This information was deemed specific enough to warrant disclosing account information to the requesting Dutch authorities. A similar case based on the bilateral agreement between South Africa and Switzerland has not yet been tested.

Voluntary Disclosure in South Africa

Current VDP

The current VDP in South Africa is administered under the TAA with effect from 1 October 2012. The current VDP aims to encourage taxpayers to come forward on a voluntary basis to regularize their tax affairs with SARS and avoid the imposition of understatement penalties and other administrative penalties.

Any person, whether in a personal, representative, withholding or other capacity, may apply for relief under the VDP. A person that is aware of a pending audit or investigation, or of an audit or investigation that has commenced but has not yet been concluded by SARS, is, generally, excluded but could be permitted to apply for relief in certain instances.

To ensure that a VDP application is valid, a disclosure must, inter alia, involve the potential imposition of an understatement penalty in respect of the default, not result in a refund due by SARS and be made in the prescribed form and manner (Form VDP01).

The tax relief provided for under the current VDP includes the following:

No criminal prosecution in respect of any alleged “tax offence”.

Relief provided for under the table in section 223 of the TAA in respect of the imposition of an understatement penalty which could, for example, result in a reduction of an understatement penalty from 100% to 5% where SARS is of the view that the taxpayer was grossly negligent or from 25% to 0% where the behaviour is considered to be unreasonable.

100% relief in respect of an administrative non-compliance penalty, including a fixed percentage based penalty for the late payment of tax, but excluding a penalty for the late submission of a return.

No provision is made in the current VDP for an exchange control amnesty in respect of assets accumulated by taxpayers abroad in contravention of the exchange control regulations. However, a disclosure may be made to SARB in respect of such exchange control contraventions. In our experience, applicants have to pay a settlement ranging between 10% and 40% of the current market value of the taxpayer’s unauthorized foreign assets. The determination will, inter alia, depend on whether the applicant elects to retain the funds abroad or repatriate such funds.

Special VDP

The Minister of Finance proposed the Special VDP in the 2016 Budget Speech. The Special VDP will provide an opportunity for non-compliant taxpayers to regularize both their tax and exchange control affairs in respect of offshore assets and income by way of one joint process. Applications for relief under the Special VDP will apply for a limited window period of nine months commencing 1 October 2016 and ending 30 June 2017.

The Bills providing for the tax relief under the Special VDP have only been tabled on the 26 October 2016. SARS has, however, advised that taxpayers may proceed in submitting their applications which will be processed on the basis of the final Special VDP legislative framework approved by Parliament. The exchange control relief under the Special VDP is provided for in the existing Exchange Control Regulation 24 of 1961 read with the Exchange Control Circular No. 6/2016 issued on 13 July 2016 (the "Circular").

Tax Provisions

We summarize below the tax provisions of the Special VDP in terms of the Bills.

The Special VDP will apply to foreign assets held during the period 1 March 2010 to 28 February 2015 which were wholly or partly derived from receipts and accruals not declared to SARS. However, a taxpayer may also elect to apply for the Special VDP in respect of such assets which were disposed of before 1 March 2010.

An amount must be included in the taxable income of the taxpayer in the 2015 tax year equal to 40% of the highest market value of all such foreign assets (i.e. derived from undeclared receipts and accruals) determined at the end of each of the 2011 to 2015 tax years (inclusive). The market value must be determined in the applicable foreign currency and translated to South African Rand at the spot rate at the end of each tax year.

The undeclared receipts and accruals will be exempt from income tax (other than employees' tax) and estate duty in respect of any tax year ending on or before 28 February 2015.

With regard to foreign discretionary trusts, a donor (or the deceased estate of the donor) or a beneficiary may elect that any foreign asset held by the trust from 1 March 2010 to 28 February 2015 be deemed to have been held by that taxpayer for purposes of all tax legislation. As a result of this election, the trust will effectively be "transparent" for tax purposes.

No understatement penalties will be levied where an application under the Special VDP is successful. Although penalties for underestimation or late payment of provisional tax may be levied in respect of amounts that were not taken into account for provisional tax estimates, that will be included in the 2015 and 2016 tax returns by virtue of the Special VDP, such penalties may be waived in terms of section 229(c) of the TAA.

No criminal prosecution will be pursued.

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Exchange Control Relief

South African residents (individuals and entities) will also be allowed to disclose and regularize their exchange control contraventions that occurred prior to 29 February 2016 which contraventions include, inter alia, the ownership of an unauthorized foreign asset(s). South African residents who are the subject of any current and/or pending investigation by SARB into their contraventions of the provisions of the Exchange Control Regulations will not qualify for Exchange Control relief under the Special VDP.

Applicants who are granted administrative relief in respect of unauthorized foreign assets and/or structures (of whatever nature, excluding bearer instruments) may have to pay a levy based on the market value thereof as at 29 February 2016. In terms of the Circular, the relevant terms of the administrative relief in respect of unauthorized foreign assets under the Special VDP may be summarized as follows:

The applicant must make full disclosure of all unauthorised foreign assets, including details of the manner in which such assets were transferred and retained abroad, and a sworn affidavit or solemn declaration of the contravention.

The levy will be based on the market value of the assets as at 29 February 2016 and will be 5% if the assets are repatriated to South Africa or 10% of the assets are retained abroad (which levy must be paid from foreign-sourced funds). The levy will be 12% if the assets are retained abroad and the levy is not paid from foreign-sourced funds. If the assets are in multiple foreign currencies, the market values may be converted into US Dollars for purposes of calculating the levy.

Applicants will not be allowed to deduct any exchange control allowance or any remaining portion thereof from the leviable amount.

Special rules apply to donors of foreign discretionary trusts in terms of which the donor (or the deceased estate of a donor) may elect that unauthorised foreign assets held by the trust are deemed to be held by that donor.

The Circular also provides for administrative relief outside the SVDP in respect of required disclosures which do not attract any levy but which may be made within the SVDP period to an Authorized Dealer. For example, such declarations would include a formal declaration by an immigrant of their foreign assets, a declaration by a resident who became entitled to a foreign inheritance from a non-resident estate prior to 17 March 1998 or to a foreign inheritance from a resident estate with foreign assets, as well as a declaration by a resident who earned foreign income prior to 1 July 1997 which was required to be repatriated to South Africa.

There are separate application forms for the tax and the exchange control relief so an applicant may apply for either or both types of relief as required.

Voluntary Disclosure in Switzerland

Under Swiss tax law, taxpayers are offered a voluntary disclosure programme for undeclared assets and/or income, which are subject to taxation in Switzerland. The voluntary disclosure programme is also available to heirs in the case of succession. To benefit from the voluntary disclosure programme,

the application must be filed for the first time in the taxpayer's lifetime and deemed voluntary. In addition, the authorities may not have had knowledge of the undeclared assets and/or income before. The applicant must commit to support the authorities without reservation in their investigation and must make serious efforts to pay the additional taxes. In such cases, there is no criminal punishment, but the taxable person is obliged to pay the additional taxes for up to ten years as well as default interest.

If the conditions for a non-punishable voluntary disclosure are not fulfilled, criminal proceedings are instituted. However, in case of voluntary disclosure, the fine may be reduced to one fifth of the evaded tax, whilst in ordinary tax evasion proceedings, the fines are between one third of and treble the amount of the evaded tax.

Please note that the non-punishable voluntary disclosure is only possible in cases of tax evasion and not tax fraud, the latter involving the forgery of documents and thus a higher level of criminal intent. The differentiation is a uniquely Swiss phenomenon and clients are well advised to seek advice from local counsel to review whether they are eligible for voluntary disclosure. Because the non-punishable voluntary disclosure is a one-time possibility only, it is very important for participating clients to disclose all the assets and/or all the income that has previously not been declared.

Closing remarks

The Special VDP should be viewed in light of the increased focus of the South African authorities on previously undisclosed funds as well as the realities of the situation in Panama which has led to an undertaking by those authorities to investigate the relevant reports. As is noted in the 2016 Budget Review, it is becoming clear that, "with a new OECD global standard for the automatic exchange of financial information between tax authorities coming into effect from 2017, time is running out for taxpayers who still have undisclosed assets abroad. "With the announcement of the introduction of the AEOI as from 2019, time is becoming of the essence for persons with undisclosed assets in Switzerland or South Africa to disclose such assets now, e.g. via voluntary disclosure programmes, and become compliant. The Prager Dreifuss tax and litigation team will gladly assist you, should you have any questions in this regard. We will gladly also put you in contact with South African colleagues regarding queries pertaining to South African tax matters.

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