STEP Society of Trust and Estate Practitioners

Login

Home » Journal

Caught in the middle

Simone Nadelhofer and Jan-Philip Elm, December 2014

Dr Simone Nadelhofer is a Partner and Jan-Philip Elm is a Junior Associate with LALIVE

Dr Simone Nadelhofer and Jan-Philip Elm discuss the challenges that financial intermediaries face under the proposed new anti-money laundering rules in Switzerland.

On 16 February 2012, the Financial Action Task Force (FATF) adopted 40 revised *Recommendations* on money laundering. Even though these recommendations are not binding, they incentivise member jurisdictions, including Switzerland, towards implementation by exposing them to reputational risks in case o non-compliance.

In light of Switzerland's ambivalent record with the OECD and the upcoming mutual evaluation by the FATF 2015, the Swiss government presented in December 2012 its strategic orientation for its financial market policy, covering, among other matters, the fight against financial crime and enhanced due diligence in the ar of taxation (also referred to as the 'white money strategy').

In February 2013, two draft Bills were submitted for consultation: revised rules implementing the 2012 FATF *Recommendations* into Swiss law; and the introduction of new due diligence requirements for financial intermediaries (FIs) in the Swiss federal *Anti-Money Laundering Act* (AMLA), to prevent untaxed assets from being accepted.

While the latter Bill was put on ice in November 2013 due to widespread criticism in the consultation,[1] in December 2013 the Federal Council drew up a dispatch for the attention of Parliament on the implementatio of the 2012 FATF *Recommendations*. If adopted, the proposed amendments to the anti-money laundering rules would have far-reaching consequences for FIs. Below is an overview of some of the proposed changes

A new tax-related predicate offence to money laundering

To date, only felonies (i.e. offences subject to imprisonment of more than three years) qualify as predicate offences to money laundering under article 305*bis* of the Swiss *Criminal Code* (SCC), but not misdemeanours such as tax evasion and tax fraud related to direct taxes. Currently, only aggravated tax fraud related to indirect taxes in cases of cross-border movement of goods qualifies as a felony, therefor constituting the only tax-related predicate offence to money laundering to date.

It has been suggested the scope of article 305*bis* SCC be extended so as to include tax fraud related to dire taxes if the amount of tax evaded exceeds CHF200,000.[2] As this will only apply to offences committed after its entry into force, the revised article 305*bis* SCC will have no retroactive effect.

If an FI knows or has reasonable grounds to suspect assets involved in a business relationship are related to tax fraud, the FI will be under an obligation in future to file a report with the Money Laundering Reporting Office Switzerland (MROS). Non-compliance with this reporting obligation will give rise to criminal liability in the form of a fine of up to CHF500,000 and may entail Swiss Financial Market Supervisory Authority (FINMA sanctions. It requires a high level of expertise to assess whether evaded taxes exceed CHF200,000 or not (especially in cases of tax offences committed in foreign jurisdictions). One may wonder whether such provisions should not address professional tax advisors, rather than FIs. Further discussions should, therefore, address requirements and processes for FIs when dealing with these questions.

With regard to indirect taxes, fraud related to domestic taxes such as value added tax (VAT), stamp duty and withholding tax will equally qualify as a predicate offence in future. Gift and inheritance taxes are, however, excluded from the scope of application of the revised article 305*bis* SCC.

Enhanced transparency of legal entities

The FATF *Recommendations* require adequate, accurate and timely information on the beneficial ownership and control of legal persons. In contrast, in Switzerland, bearer shares of unlisted joint stock companies still allow for shareholders' anonymity.

Under the revised rules, companies with bearer shares henceforth would have to choose from four regimes. Companies may choose to impose: (1) mandatory disclosure to the company of the shareholders' identity; a the identity of the beneficial owner(s) – that is, the physical person(s) – if the shareholders' stake is 25 per cent or more of either voting rights or share capital. Or, alternatively, the company may opt for a mechanism imposing (2) mandatory disclosure of the shareholders' identity to an FI required to inform the company in th same manner as prescribed by the first option. Eventually, the company may equally fulfil the new disclosure requirements by (3) issuing bearer shares in the form of un-certificated securities consigned to a securities account by a custodian, or by introducing (4) a simplified conversion of bearer shares into registered shares.

Under regimes 1 and 2, the board of directors of unlisted joint stock companies with respect to the FI will hav to keep a record of the company's shareholders and, possibly, their beneficial owner(s). Either way, the boar of directors will have to ensure that no shareholder exercises their monetary and voting rights without proper disclosure. Intentional non-compliance with those duties would entail criminal liability punishable by a fine. It proposed that the requirements would apply equally to open-ended collective investment vehicles, limited liability companies, cooperatives and foundations.

In light of the new rules, fiduciary companies and their employees acting as directors for companies of their clients would be well advised to inform their clients and implement new internal procedures addressing the proposed changes ahead of time.

Identification of beneficial owners

Currently, FIs are required only to identify the beneficial owners of domiciliary companies. The FATF *Recommendations*, however, rely on the guiding principle of identifying the physical person(s) behind all lega entities. Accordingly, under the revised AMLA, FIs will face a general obligation to identify the beneficial own (s) of assets. In other words, FIs will have to identify the beneficial owner(s) in terms of physical persons not only with respect to domiciliary companies, but also with regard to all unlisted operative legal persons if the stake of one of their shareholders is (directly or indirectly) 25 per cent or more of either voting rights or share capital or if the shareholders have control over the company in any other perceptible manner.

As the Swiss federal *Stocks Exchanges and Securities Trading Act* (SESTA) already implements similar duties with regard to listed companies, information on beneficial owners of all legal persons will thus be available in the future.

Extension of enhanced due diligence requirements to domestic politically exposed persons

To date, only foreign politically exposed persons (PEPs) are considered as high risk and are subject to the FI's enhanced risk assessment. The new definition of PEPs would further include national PEPs and person: occupying (or having occupied) an important position in or on behalf of an international organisation, and als respective related persons, i.e. related persons of national PEPs and related persons occupying or having occupied an important position in or on behalf of an international organisation. With regard to the FI's risk assessment, PEPs regulations ought to be applied to those new categories of PEPs if they are subject to additional criteria pointing at a business relationship with higher risk.

Restrictions for cash payments for the purchase of both movable and immovable property

According to the FATF *Recommendations*, anti-money laundering requirements are to be extended to designated non-financial businesses and professions.

It is proposed that the AMLA be amended, in a narrowly confined manner, so as to include contracting partie pursuant to article 184 and following of the *Code of Obligations* (CO), recording persons (e.g. notaries), and land registries. More specifically, all cash payments in excess of CHF100,000 for property purchases or sale of movable property are to be arranged through an FI subject to the AMLA. Non-compliance with these new requirements will entail criminal liability punishable by imprisonment for up to one year or a fine.

The two chambers of the Swiss Parliament (the National Council and the Council of States) have opposed th Federal Council's proposal to restrict cash payments. The solution now discussed would allow cash paymen without limitation, while introducing new duties of care and identification, as well as a reporting obligation for professional traders of goods. This is similar to the rules that already apply to FIs under the AMLA, if traders accept cash payments in excess of CHF100,000.

Suspicious activity reports

Under current anti-money laundering requirements, FIs are to freeze assets in connection with a suspicious activity report (SAR) until a decision is made by the relevant criminal authority, but for no longer than five days, during which the FI is prohibited from informing the client of either the SAR or the freezing of assets. Under the revised AMLA, the freezing of assets is to be delayed in order to give the MROS and the relevant criminal authority more time for in-depth analysis of the suspected case. Notification of the MROS in case of SAR would not entail the automatic freezing of assets. Instead, the FI is only required to freeze respective assets for up to five days if the MROS forwards the case to the relevant criminal authority, which the MROS will be required to do within 30 days.[3]

In order to prevent early withdrawal of suspected assets by the client, a new provision additionally requires F to inform the MROS of any order that might prevent forfeiture of those assets and to delay the transaction pending the MROS' decision, but for no longer than five days. In a similar manner as under the current reporting procedure, the FI would equally be prohibited from informing the client of either the SAR or any further notification.

Next steps

While the Council of States approved most of the Federal Council's dispatch, in June 2014 the National Council fiercely disputed most of its essential provisions. Among others, it opted for an exception to the bear shares regime that would not include most unlisted companies, and for the exclusion of members of the National Council from the new PEPs regulation. It appears the National Council does not fear a confrontatio with the OECD on this issue.

It remains to be seen whether the reality will be as drastic as it seems today. At least some of the new rules may become obsolete after the introduction of automatic exchange of information, possibly as early as 2017

1. The proposed rules on tax due diligence will be reconsidered after the introduction of automatic exchange of information, and only with regard to countries with which Switzerland will not have entered into a respective treaty. To this end, in June 2014, the Federal Council launched a consultation on a new *Financial Institutions Act* (FIA). The FIA aims to unify the supervision of all financial service providers th offer asset-management services under one piece of legislation, and also discusses tax-related due diligence requirements
2. In March 2014, the Council of States discussed raising the threshold to CHF300,000
3. In September 2014, the Council of States discussed reducing the MROS' deadline to 20 days

Estates

Taxation

The Client

The Practitioner

Trusts and Foundations

Wills and Succession