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Date : 17-May-2011 Edition : Mumbai Page No.: 9 Page Name: n.a. Size: 323.55 sq. cm

Sector: Banking and Finance Circulation: 20000 AVE: INR 40443.26 Frequency: Daily

News monitored for: E&Y

THE FINANCIAL EXPRESS

Bank secrecy on the back foot

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After the First World War, in the general environment of economic depression, some European countries like Germany, Austria, Luxembourg, Liechtenstein and Switzerland stumbled upon the policy of banking secrecy to augment their public revenues and attract investments. Austria and Germany had been humbled in the war and were financially distraught. The others followed suit. All these countries promised to the investors a secrecy of investment in their banks, from the prying eyes of the outside world. They made laws to enforce banking secrecy around 1934. Originally, people from other European countries, mainly individuals, availed of the benefit. After the Second World War, people of different hues and colour from all over the world suddenly became rich. They eyed the banks from these countries as places for hiding their wealth in safety and the banks, in return, promised to maintain the secrecy of their investments from the governments of their countries. It is rumoured that the agents of these banks operated in various countries, scouting for prospective investors. Subsequently, several other jurisdictions, namely, Panama, Cayman Islands, Singapore, Hong Kong, Lebanon etc took up this lucrative activity. The banks, along with the help of the tax havens, helped large business groups to put up tax efficient business structures all over the world.

Around the 1940s, prompted by League of Nations, European nations started entering into double taxation avoidance agreements among themselves. Slowly, such agreements also spread to other countries because of the growth in cross-border commerce. All the agreements contained a provision for the exchange of information between the countries, as is necessary for carrying out the provisions of the treaty or the domestic laws of the countries concerning taxes. The information could be used by a country only in connection with taxation proceedings and was to be kept secret. However, such exchange of information was subject to the restriction of the national laws. As such, the countries with bank secrecy laws were not required to divulge bank information.

The murmur against harmful tax competition started being heard from economically powerful nations in the nineties. In 1996, ministers of the OECD countries called upon the organisation "to develop measures to counter the distorting effects of harmful tax competition on investments and financing decisions and the consequences for national tax bases". In 1998, the OECD came out with a report containing several recommendations, including requiring countries to review laws and practices to seek transparent exchange of banking information.

Switzerland and Luxembourg decided to abstain from adopting the report. Germany and Austria did not oppose. Luxembourg made peace with the EU by proposing to levy withholding tax on interest payouts from its banks. Switzerland stuck to its guns, promising to lift the veil only in cases of established frauds. It insisted that a country must prove the tax fraud committed by its resident to get information of bank deposits of that person in Switzerland, which is a difficult proposition, as tax fraud cannot be proved without the bank information. In 2001, Indian tax officials, in the course of a search operation in the premises of Pune's stud farm owner Hassan Ali, came across information regarding substantial deposits held by him in a Swiss bank account. They raised a huge tax demand on him but could not make any headway with the Swiss government. A German citizen who was a former Swiss banker disclosed particulars of bank accounts held in his bank by customers, but Switzerland sought to prosecute him for violation of banking secrecy laws.

In 2005, the OECD model convention was amended to provide that no country should decline to supply information solely because the information is held by a bank or other financial institution. After the world economic depression of 2007-08, the G20 also joined hands with the OECD. But it was really the US that tore open the secrecy veil of Switzerland in 2010. Faced with isolation, Switzerland agreed to adopt the OECD model on exchange of information and renegotiate all its treaties. Switzerland has finally given up on its law of bank secrecy and an amendment in this regard is pending ratification in the Swiss Parliament. It has also renegotiated its treaty with India recently, pending ratification by legislatures in both countries.

For the past year, voices are being heard in India against black money held by Indians in secret bank accounts abroad. Germany, on request from the Indian government, has disclosed particulars of around 800 secret bank accounts held in Germany by Indians. Information will hopefully be divulged by Switzerland in the near future, if the Indian government requests. Still, there are a large number of jurisdictions in the nooks and corners of the world that are prepared to lend secrecy away from the spotlight.

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