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Banking confidentiality – a shaky pillar in the financial centre

Banking confidentiality is sacrosanct for the Swiss. But pressure from abroad on the Federal Council and the banks is growing – Switzerland is seen as a tax haven facilitating tax evasion. How much longer can this cornerstone of the Swiss banking industry survive? By Rolf Ribi

“It is clear that a major avalanche is approaching Switzerland, and the risks are significant considering the economic importance of Switzerland’s financial centre”, Thomas Borer, the former Swiss ambassador in Berlin, warned recently. Switzerland is “always seen in terms of banking confidentiality and tax evasion”.

Indeed, Switzerland’s banks and tax regime have come in for all sorts of criticism recently. Germany has accused Switzerland of nothing short of “assisting tax evasion” for rich citizens with assets in Swiss banks. The European Union has reproached Switzerland over preferential taxation for international companies in individual cantons. The Organisation for Economic Co-operation and Development (OECD) is also calling for Switzerland to exchange bank information for tax investigations. The USA is putting pressure on Switzerland to cooperate with the taxation of American citizens with securities in Swiss banks and to reveal the names of the banks’ customers.

Banking confidentiality since 1934

The criticism from abroad is essentially aimed at a specific feature of the Swiss system – banking confidentiality, enshrined in Article 47 of the Swiss Federal Act on Banks and Savings Banks of 1934. This states that anyone with access to confidential information acting in a capacity as an employee or agent of a bank, or as an auditor, must not reveal it to third parties. Deliberate or negligent infringement of banking confidentiality is “punishable with imprisonment of up to six months or fines of up to CHF 50,000”. Anyone who entrusts his or her assets to a Swiss bank can therefore rely on the discretion of the bank and its employees.

How did this Swiss style of banking confidentiality come about? There are two differing accounts of the historical background to banking law in Switzerland. Until the 1980s, Federal Councillors and bank presidents were still propagating the myth of the pro-

tection of Jewish assets from the Nazis. It was in actual fact domestic banking crises and targeted informant action abroad to trace assets brought to Switzerland that led to banking confidentiality. The costly salvation of the Swiss Volksbank by the federal government and the revelation of informant activities particularly highlighted that the time was right for a national banking law. The law was passed practically unanimously by Parliament in November 1934 and entered into force on 1 March 1935.

Tax fraud and tax evasion

Banking confidentiality has never applied in absolute terms. It may be revoked if ever a customer is prosecuted for an offence, i.e. if a crime has been committed in the eyes of the law. In cases of tax fraud and criminal activities, the banks are obliged to disclose tax information and legally assist the prosecuting authorities. Tax fraud is when a taxpayer uses false or falsified documents in his tax declaration. But what if he simply “forgets” to declare certain assets and income? Under Swiss law, this “only” constitutes tax evasion, which is punished without criminal proceedings. This differentiation between tax fraud and tax evasion protects foreign taxpayers with assets in Swiss banks from foreign authorities because Switzerland does not provide administrative or legal assistance to foreign countries in cases of tax evasion.

How is this differentiation justified? According to Martin Killias, a professor of criminal law in Zurich, someone who deceives the tax authorities with false accounting or by using falsified documents displays greater criminal cunning than someone who “only” fails to declare certain income. Returning an incomplete tax declaration is therefore not tax fraud. The tax authorities could in any case demand to see all the necessary evidence. Tax evasion is more appropriately dealt with using administrative proceedings punishable with fines, rather than custodial sentences.

“Banking confidentiality does not exist to protect tax evaders. It protects the human right to privacy”, explains Beat Bernet, a banking professor from St.Gallen. He goes on to say that whoever claims this right must, however, “give the state what it is entitled to”. Banking confidentiality will “probably remain one of the most important pillars of our financial centre for some time to come”. But the differentiation between tax fraud and tax evasion is something “we will not be able to maintain for much longer”.

The “Neue Zürcher Zeitung” sees banking confidentiality as the expression of a “liberal philosophy of government that values the individual above the state, and voluntariness above compulsion” and argues that “protecting the privacy of the individual, principally against the state, is a key element of this philosophy”. According to the author, Gerhard Schwarz, the differentiation between the “offence” of tax evasion and the “crime” of tax fraud constitutes a philosophy “that respects citizens rather than treating them as property of the state”. Evading taxes is “not simply an act of greed and criminal behaviour, but a reaction to a level of taxation deemed unfair”.

Professor of business ethics, Peter Ulrich, has nothing against banking confidentiality as long as it provides legitimate protection for the privacy of citizens. He says: “From an ethical standpoint, criticism can be levelled at the opportunity deliberately created by Swiss legislation to abuse banking confidentiality to conceal tax evasion owing to the distinction between tax fraud and tax evasion”. As Switzerland can deny international legal assistance in matters to do with tax evasion, “our authorities are providing a dubious haven for foreign capital”. In so doing, “Switzerland is poaching sources of tax income from other countries, costing them billions in lost tax revenues each year”. According to Professor Ulrich, there is “no civil right to tax evasion”. He believes that anyone who is evading taxes in his own country is “using public services financed by taxes without contributing his fair share based on his ability to pay”.

A stronger Swiss financial centre

The strength of the Swiss banks lies in “private banking”, i.e. asset management for the rich and extremely rich. More than CHF 4000 billion (CHF 4 trillion) in foreign assets is held in Swiss banks. The reasons for

this include the high level of expertise and professionalism of Swiss bankers, the attractive range of investment instruments, and also the discretion of the banks in view of banking confidentiality. Deutsche Bank estimated a few years ago that seventy percent of undeclared foreign assets were in Switzerland. This meant a total of around CHF 3000 billion in untaxed "illegal funds". "Most foreign investors who deposit their money in Switzerland are avoiding taxation", confirmed private banker Konrad Hummeler.

Swiss banks are also world leaders in offshore business, where transactions are carried out using tax havens. The traditional offshore centres, such as the Cayman Islands, Jersey and the Bahamas, levy no or virtually no corporate taxes, allow the setup of offshore companies, impose strict banking confidentiality and provide no international legal assistance. There are around fifty offshore banking centres worldwide that depend on attracting foreign capital and providing administrative protection and tax exemption to a large extent. According to "the Berne Declaration", an organisation that is critical of the situation, several hundred thousand offshore companies are managed from Switzerland, and "a large proportion of these are used to avoid taxation".

Is banking confidentiality the lifeblood of our financial centre? "Yes, absolutely", replied banker Konrad Hummeler, referring to the "strategic importance of our banking confidentiality". It is little wonder that the international community is tackling the discretion of Swiss banks on a number of fronts.

Withholding tax for Europe

Switzerland has offered the European Union a helping hand in the fight against tax fraud and tax evasion on numerous occasions. Switzerland offers legal and administrative assistance with tax fraud, but not with the evasion of direct taxes. This is underlined by Berne's commitment to the cross-border savings tax. Switzerland levies a withholding tax (up to 35% in 2011) on the interest income of natural persons and repays 75% of that to the investor's country of residence. Switzerland does not however have to reveal the names of bank customers from abroad. "Banking confidentiality is cast in stone for at least 15 years", said the former president of the Swiss Bankers Association jubilantly.

In line with this agreement, Switzerland paid half a billion Swiss francs to EU states in interest income in 2006, and the figure is believed to have increased last year. "Much too little", protested the German Finance

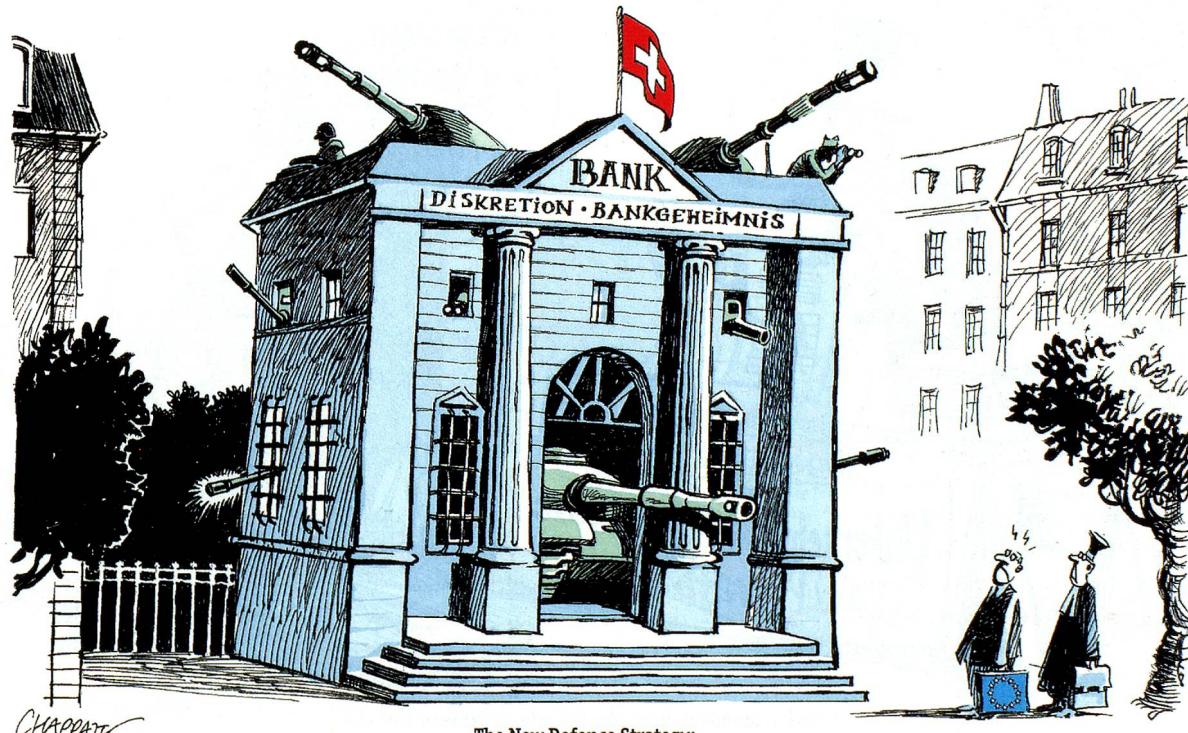
Minister, Peer Steinbrück, declaring war on "tax havens" like Switzerland. He called for the extension of the agreement to income from dividends, other investments and legal entities such as foundations. "We are not a tax haven. The savings tax is a long-term arrangement with Brussels. Our banking confidentiality is protected in various agreements with Brussels", explained Swiss Foreign Minister Micheline Calmy-Rey. "The savings tax agreement will not survive the next major round of negotiations with the extended European Union", predicts banking professor Beat Bernet.

Where indirect taxes are concerned, such as VAT and customs duties, banking confidentiality has practically been revoked. Unlike with direct taxes, it is not just tax fraud that is punishable here, but tax evasion as well, and legal assistance is provided for both areas. If Switzerland provides full legal assistance with VAT, German entrepreneurs, for example, with illegal funds can no longer rely on protection from Swiss banking confidentiality.

Tax row with Germany

The tax row with Germany has been more heated than ever recently. "In our view, the Swiss banks are in fact helping German citizens evade taxation. It is understandable that

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this makes us angry", said the former German Finance Minister, Hans Eichel. Banking confidentiality is an "invitation for foreigners to avoid paying taxes". This German politician has warned Switzerland about future bilateral negotiations with the European Union, saying that "banking confidentiality, the savings tax and cooperation with Switzerland on taxation issues are very high on the agenda".

The Swiss response has been equally forceful. "It is disrespectful to describe Switzerland as a tax haven", said Federal Councillor Hans-Rudolf Merz, in response to the criticism levelled by his German counterpart, Peer Steinbrück. "The protection of privacy through banking confidentiality is part of our system of values." The politician categorically ruled out an automatic exchange of tax information, saying "we will never revoke banking confidentiality". What is not in dispute is that tax evasion is a criminal offence in Germany and that German tax evaders "have deposited significant amounts of money in Switzerland", according to the "Neue Zürcher Zeitung".

Tax dispute with Brussels

A tax row has been raging between the European Union and Switzerland for a year now. Brussels has criticised the tax regula-

tions of individual cantons that benefit "mobile" corporations. The dispute specifically concerns tax relief on the earnings generated abroad by holding companies (which manage participations in other companies), domiciliary companies (offshore companies) and joint ventures (foreign groups mainly operating abroad). "If holding companies do not have to pay taxes on profits generated abroad, this constitutes unauthorised assistance that distorts competition", explained Michael Reiterer, EU ambassador to Switzerland.

There is no doubt that some cantons are very attractive to groups based here with European operations and to holding companies in terms of taxation. There are 20,000 such companies in Switzerland with 150,000 employees, paying four billion Swiss francs in taxes each year. The bone of contention is the different rates of taxation for income generated in Switzerland and abroad. Without these special tax regulations, Switzerland would "lose enormous amounts of tax income", admitted Gerold Bührer of the Swiss Business Federation. Federal Councillor Hans-Rudolf Merz is not prepared to negotiate with the European Commission. However, his department is assessing "autonomous" reforms of corporate taxation.

Pressure from America

Switzerland and its banks provide the USA with extensive information, and not just about tax fraud - this was the objective of the double taxation agreement between Switzerland and the USA of 2001. Swiss banks are obliged to provide the US authorities with information if American citizens have accounts and hold American securities with Swiss banks. The exchange of information and administrative assistance from Switzerland applies to "fraud and similar offences", including "the failure to present accurate and complete documents". Tax fraud and tax evasion are treated in the same way here, which contradicts Swiss law, and in fact breaches banking confidentiality.

Why has Switzerland agreed to this? The reason is because the presence of Swiss banks in New York, a key financial centre, is at stake. Swiss banks require an agreement with the American tax authorities to obtain the status of a "qualified intermediary". As such, the banks are obliged to disclose the identity of their American customers, and to levy a withholding tax on their securities earnings. "The Swiss banks have given in to pressure from the USA. Yet, our Federal Councillors are still claiming that banking confidentiality is non-negotiable", explained Philippe Lévy, former delegate of



Banking confidentiality: sign the private bankers' initiative
I'm not important - my assets are worth less than CHF 1 million.

the Federal Council for Trade Agreements.

A report in the "New York Times" caused a stir in Switzerland two years ago. As part of the campaign against terror, the US Department of the Treasury and the CIA obtained access to databases of international payment transactions. Almost all payment transactions, including those of the Swiss banks, go through the international hub, Swift, based in Brussels. American investigators gained access to information about bank customers, including Swiss citizens.

So where does all this leave Swiss banking confidentiality? The Federal Department of Finance in Berne is trying to allay fears, claiming there are no risks. However, no customer of a Swiss bank can expect that the protection of privacy guaranteed in Switzerland also applies abroad (in this case in Belgium). Bank customers today receive written notification that the banks must give their names, addresses and account numbers in cross-border transactions. Hans Geiger, a banking professor from Zurich, confirmed this situation: "The protection provided by banking confidentiality is restricted to transactions within Switzerland". The banks' customers really ought to be informed "that banking confidentiality no longer extends to cross-border transactions".

The Organisation for Economic Co-operation and Development (OECD) is also critical of Swiss banking confidentiality: "Excessive banking confidentiality and the refusal to disclose information about tax evaders are relics of the past", said Secretary-General Angel Gurría, also referring to Switzerland. "Switzerland does not comply with OECD standards on the exchange of information despite being a member state", complained the former German minister, Hans Eichel. The OECD itself describes Switzerland as "an uncooperative country" on account of banking confidentiality. Yet, Switzerland is only prepared to pass on information in cases involving tax fraud, for example.

A new form of banking confidentiality?

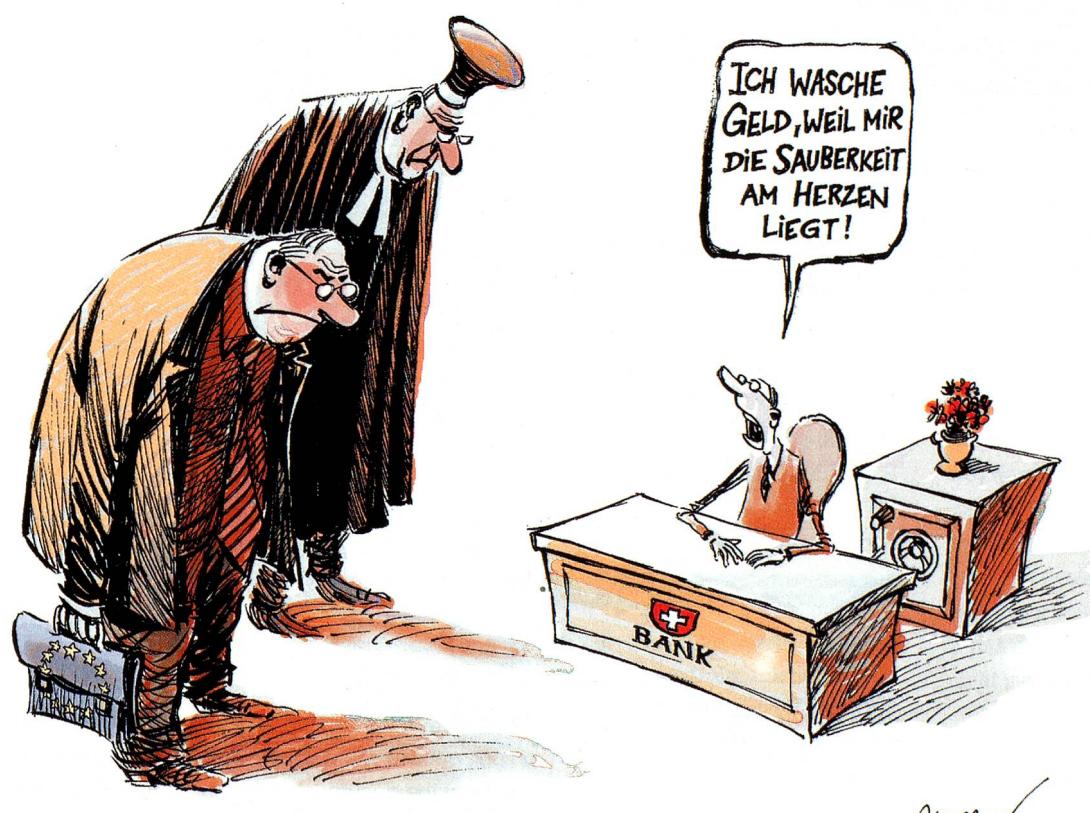
One thing is for certain – banking confidentiality is deeply engrained in the Swiss people. According to a survey carried out by the Swiss Bankers Association, 81% of interviewees wanted to retain banking confidentiality in spite of intense international pressure. Three out of four Swiss people believe "banking confidentiality is likely to still exist in its present form in five years from now". The Swiss are concerned with the protection of privacy above all else: 91% consider it right and proper that the financial details of bank customers are not made available to third parties.

Swiss people pledging support for banking confidentiality is one thing, pressure from abroad is quite another. Could a new form of banking confidentiality provide a solution? "Why doesn't Switzerland conform to international practice and revoke banking confidentiality on tax evasion? This step would take the pressure off the Swiss banks and improve our country's reputation all in one go", says Stefan Eiselin in the "Tages-Anzeiger".

According to Peter Ulrich, an expert on business ethics, Switzerland, as the world's biggest private banking centre, should be committed to establishing a fair framework for international tax competition. "In the long term, Switzerland would even be the biggest beneficiary of such a framework without tax evasion." Under these conditions, it would be the best banking services that matter, and this is the reason the Swiss banks give for their leading position in asset management. "Financial centres in banana republics, which have nothing to offer other than confidentiality for tax evasion, would be left with nothing."

DOCUMENTATION

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