

Passing on a foreign tax on interest income to clients during the term of a fixed-rate mortgage

Topic: **Fees and charges** Case number: **2020/30**

The long-term clients residing in Italy concluded a five-year fixed-rate mortgage on their holiday home in Switzerland with the bank in August 2019. In mid-December 2019, the bank informed the clients that from 1 January 2020 it would pass on to them the tax levied by the Italian government on interest income generated by the bank from clients resident in Italy. This increased the costs of the fixed-rate mortgage by 14%. The clients did not agree and wrote to the bank several times to complain. When they failed to reach an agreement, they submitted the case to the Ombudsman. The Ombudsman asked the bank to reconsider its position. The bank then had a discussion with the clients and waived the passing on of the tax for the duration of the current fixed-rate mortgage.

In its responses to the customer complaints, the bank had explained that, among other things, it had to comply with foreign tax regulations due to FINMA Circular 2008/21 on the operational risks of banks and was therefore obliged to pay the interest income tax in question to the Italian tax authorities. It had borne this tax itself until the end of 2019. From 1 January 2020, it would pass the tax on to the clients, which it was entitled to do on the basis of its general terms and conditions acknowledged by the clients. The provision on which the bank relied stated that all taxes and duties were to be borne by the client. Any taxes and duties levied at or from the bank in connection with a client's business relationship, or which the bank was required to withhold under Swiss law, international treaties or contractual agreements with foreign bodies, as well as any expenses incurred by the bank, would be charged to or passed on to the client.

The clients were of the opinion that the tax law which, according to the bank, contained the obligation incumbent on it to pay tax to the Italian state on the interest income on the mortgage granted to the clients was not new. This law had already existed for years when the mortgage was taken out. The bank had apparently assumed that the law did not apply to it. Due to a reinterpretation of this law, it had probably now come to the conclusion that it had to pay this tax and had wanted to pass on this additional tax burden to the clients who had triggered the tax in question due to their place of residence. According to the clients, the bank should have taken into account the taxes and levies it had to bear when setting the price for the fixed-rate mortgage in August 2019. Without an explicit contractual basis, it could not increase this fixed price simply because it became aware of a tax liability affecting itself that it had not previously taken into account.

After reviewing the documents and the contractual basis invoked by the Bank, the Ombudsman had considerable doubts as to whether there was a sufficient contractual basis for the disputed passing on of the interest income tax to customers and whether it was therefore legally valid. He therefore asked the bank to re-examine the case. He advised the bank that so-called "tax gross-up" clauses, which have the purpose of guaranteeing a lender a certain interest income and therefore obligate the borrower to pay newly levied taxes and duties in addition to the agreed interest during the term of the contract, were indeed common in the structured credit agreements used in the corporate and wholesale business. In the Ombudsman's experience, however, they were rather unusual in the Swiss retail banking business. The provision from the bank's general terms and conditions used by the bank as justification appeared to be aimed more at withholding taxes, which ultimately affect the client.

The Ombudsman found it highly questionable that the bank could use this provision to pass on to the client a tax on its own interest income.

It is obvious that the bank finances the taxes and levies affecting it with the income it earns. The Ombudsman shared the clients' view that the bank must take this circumstance into account when setting the price, i.e. the interest rate of a fixed-rate mortgage. If it misjudges its tax situation and has to bear a higher tax burden due to the reinterpretation of a tax law, it can hardly pass this on to the client for the duration of the fixed interest rate agreement.

After noting these concerns, the bank decided to talk to the clients again and finally waived the passing-on of the interest income tax for the duration of the current fixed-rate mortgage, whereupon the Ombudsman closed the case.