Swiss Banks seek fresh start with US Disclosure Programme

The US government has been waging a sweeping, multi-faceted law enforcement campaign to stop offshore tax evasion by US persons concealing funds overseas since 2008. With an initial focus on the Swiss banking community, the US Department of Justice (DOJ) and Internal Revenue Service (IRS) have sought to uncover the identities of US account holders and facilitators by pursuing a creative strategy including cross-border enforcement litigation, civil compliance programmes, criminal prosecutions, penalties and forfeitures.

BY MIRIAM L. FISHER

The most recently announced disclosure programme for Swiss banks is designed to achieve a reckoning of any past misconduct along with prospective compliance with US laws, providing the potential for a fresh start for Switzerland's financial community, which has been tarnished by years of damaging revelations. The programme promises to lead to further efforts aimed at combating global tax avoidance and may serve as a model for future cross-border law enforcement.

The ongoing IRS Offshore Voluntary Disclosure Programme (OVDP), begun in 2009, has thus far brought into compliance over 43,000 US taxpayers with previously undisclosed foreign accounts, offering amnesty from prosecution in exchange for full disclosure and the payment of back taxes and steep penalties.

The DOJ has criminally prosecuted more than 100 persons, including non-disclosing US account holders, bankers and other perceived enablers. One Swiss bank has pleaded guilty to US tax crimes and ceased operations; another has entered into a deferred prosecution agreement and cooperated with US authorities. Fourteen Swiss banks are known to be under continuing US criminal investigation.

These enforcement activities have generated more than US$6 billion in US tax revenue, civil penalties and criminal sanctions. These efforts to rein in US offshore tax evasion will be significantly enhanced by the implementation of the Foreign Account Tax Compliance Act (FATCA), whereby mandatory financial institution disclosures, via direct agreement with the IRS or intergovernmental agreements, and the potential for severe sanctions will make it increasingly difficult and risky for banks to assist non-compliant US taxpayers.

Swiss bank disclosure programme

The newest phase of the tax enforcement campaign, crafted jointly by the DOJ and the Swiss government, was announced on 29 August 2013. This disclosure programme, aimed directly at the Swiss banking community, presents a path forward for Swiss banks facing potential criminal prosecution in the US. The DOJ offered Swiss banks a brief opportunity to participate in an amnesty programme that resembles

ABOUT THE AUTHOR:

Miriam Fisher is global co-chair of the Tax Controversy Practice Group at US law firm Latham & Watkins. Her practice focuses on federal tax controversy and litigation, including complex civil and criminal tax matters. Chambers USA rank her in Band 1 for both Nationwide Tax Controversy and Tax Fraud. Previously Ms Fisher served as special assistant to the Assistant Attorney General for the US Dept. of Justice Tax Division and was an adviser on federal tax compliance policy and criminal enforcement initiatives. She was also an adjunct professor in the graduate tax programme at Georgetown University Law Center.

the IRS's OVDP. In exchange for substantial disclosures and payment of a penalty, Swiss banks can receive a non-prosecution agreement from the DOJ. Even Swiss banks that believe they are compliant with US law can participate and secure a "non-target letter" – confirmation that the US has no intent to investigate the bank with respect to any criminal violations. Full cooperation and complete disclosure is required to complete the bank disclosure programme successfully. Failure to participate or to comply with the terms of the programme, however, brings with it the continuing material risk of US criminal prosecution.

As the first phase of the Swiss bank disclosure programme came to a close on 31 December 2013, the DOJ received 106 letters of intent to participate in the programme. Previous efforts to achieve a global resolution between the US and Switzerland with respect to undisclosed accounts held by US persons had been frustrated when the Swiss parliament and Swiss courts rejected measures to allow Swiss banks to make disclosures in respect of suspected US tax evaders. Similarly, the US Senate failed to ratify a 2009 protocol that would have facilitated Swiss banks handing over data on suspected tax cheats. Thus, early evidence of the DOJ bank disclosure programme's success is noteworthy, and its long-term impact could be substantial.

Disclosure requirements

The bank disclosure programme provided an initial four-month period in which a bank concerned about potential prosecution in the US could notify the DOJ of its intention to participate. There follows a four to six-month window within which the bank must: gather and produce significant amounts of data; work with an "independent examiner" approved by the DOJ to review and verify the accuracy of that data; and schedule an in-person presentation to the DOJ detailing the operation of the bank's US account holder business.

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A participating bank must provide: (i) a description of the structure and operations of the bank's cross-border account business (including information about operations outside of Switzerland); (ii) the names of individuals who oversaw the cross-border account business; (iii) a description of the bank's methods of attracting and servicing account holders; and (iv) the total number and aggregate dollar value of the bank's cross-border accounts. The disclosure must include specific details and identities relative to each US-related account. The bank must also agree to close the account of any account holder who refuses to provide the necessary information or disclosure waivers required under the programme.

Before the DOJ enters into a non-prosecution agreement with the bank, the bank must also pay the US a sizable monetary penalty. The contemplated penalty escalates on a scale of between 20% and 50% of the aggregate undisclosed account balances, depending on when the accounts were opened. However, certain penalty reductions are available if the bank facilitated prior disclosure of US-related accounts to the IRS, either by the US accountholder or by the Swiss bank. Accordingly – and as US authorities no doubt expected – prior to submitting letters of intent, many Swiss banks contacted account holders to ascertain whether they had already participated in the IRS OVDP and, if they hadn't, to encourage them to do so. Some recalcitrant account holders have had their assets frozen. This precipitated a fresh wave of OVDP disclosures to the IRS beginning in late 2013.

In the second phase of the DOJ's bank disclosure programme, Swiss banks that do not believe they have violated US law and also those deemed FATCA compliant (generally, those with a local client base) have until 1 July 2014 to submit a letter of intent to participate. These banks are subject to a less onerous set of disclosure obligations and can obtain a non-target letter upon successful participation in the DOJ programme. The benefit of such participation, even for these presumably non-culpable banks, is getting a written clean bill of health from US tax authorities, eliminating, prospectively, the cloud of allegations of widespread facilitation of US tax evasion by the Swiss banking community.

Risks for Swiss banks

Weighed against the alternative of potential US criminal probes, many Swiss banks have chosen to participate in the US programme, and undoubtedly more will follow in the second phase. Participation in the disclosure programme, however, is not without risks for Swiss banks.

First, there is no *de minimis* exception for a violation of US law. If a "second-phase" participating bank is found to have violated US law but failed to participate in the first phase of the programme, the bank risks disqualification from the programme. Disqualification raises the risk of prosecution and even the mere risk of prosecution can be catastrophic for a financial institution.

Second, a significant element of the success of the OVDP has been the generation of a wealth of "leads" concerning enablers of US – as well as

non-US – tax evasion across the globe. Thus, US authorities are already in possession of vast amounts of information concerning US account holders and shady foreign banking practices. That information will be used to cross-check the accuracy of bank programme disclosures.

Third, the DOJ programme is reasonably expected to expose additional players the US may target for enforcement. The programme requires disclosure of information, not only about account holders, but also about former and current bank executives and employees, outside advisers, and banks in other countries that received transfers of funds from US-related accounts closed by the participating bank. Notably, amnesty is afforded only to the participating financial institutions and not to any individuals exposed by the programme's sweeping disclosure requirements. Thus, participating banks may be exposing employees, customers, professional advisers and others in the banking community to considerable risk.

Fourth, an unprecedented increase in intergovernmental information sharing, spurred by the implementation of FATCA, is already in evidence as other countries begin to follow the lead of successful US tax enforcement activities directed at offshore evasion. This raises the risk of tax enforcement activities by countries other than the US, including from leads based on information uncovered by the US and shared under an increasing number of intergovernmental cooperation agreements aimed at combating global tax evasion.

Time is running out

Thus, the DOJ bank disclosure programme is likely to lead to vigorous and continued enforcement efforts against those who fail to come forward, as well as those whose activities are revealed and who are not protected by the programme's amnesty.

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In particular, the prospects for hiding assets and remaining undetected are dimming for US persons with beneficial interest in secret offshore accounts anywhere in the world, including assets held through corporations, partnerships or trusts. There is still time to participate in the OVDP, but US account holders will become ineligible and risk criminal prosecution if banks participating in the DOJ programme or subject to any of the new global regulatory schemes (or, for that matter, any other third parties in the US's cross-hairs) disclose the account holder's identity before the person applies for OVDP benefits. The IRS has also warned that it may, at any time, designate specific banks whose account holders will no longer be eligible to participate in the OVDP.

Time is running out as well for financial institutions that remain at risk for facilitating potential violations of US tax law. As noted, 14 Swiss banks remain under US criminal investigation and the DOJ programme may add to that list. For this group, possible prosecutions, deferred prosecutions involving cooperation agreements and potentially significant sanctions may ensue. US Senate investigative hearings in late February 2014 continued to shine a spotlight on the evolving offshore tax evasion crackdown and the role of the international banking community. Importantly, the DOJ bank disclosure programme is likely to serve as a template for US enforcement efforts in jurisdictions outside Switzerland. In addition to the bounty of leads developed from OVDP disclosures implicating banks in numerous other jurisdictions around the world, the DOJ has described its bank disclosure programme as a mechanism to "follow the money" of US account holders who may have moved Swiss bank-held funds to other countries. Banks in those jurisdictions are expected to become the focus of continued enforcement activities.

The broader impact of US tax enforcement efforts on the global banking community is tangible and signals further retrenchment for bank secrecy. Prior to FATCA's implementation, numerous countries are entering into Intergovernmental Agreements that require routine bank reporting to the authorities in respect of the financial interests of US persons and the exchange of such information with the US. And, notably, the Organisation for Economic Cooperation and Development (OECD) has just proposed a new global standard that would mandate multi-lateral financial institution reporting, with the collection and automatic annual exchange of such information between countries' tax authorities to increase global tax compliance.

Following the format of the IRS OVDP, the Swiss/DOJ bank amnesty programme has utilised a carrot-and-stick approach to encourage institution-level disclosure and compliance in a creative and aggressive cross-border law enforcement model. Given its early apparent success, the programme stands to achieve what Swiss and US legislators could not – nearly full disclosure of any remaining non-compliance by US account holders, a framework for future financial institution compliance with US tax laws and the equivalent of a "clean slate" for the Swiss banking community. It stands as a noteworthy achievement in the battle to increase global tax compliance.