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Tax Litigation Issues

Expert Analysis

Accessing Records With Bank of Nova Scotia Summonses

By **Jeremy H. Temkin**

In a recent interview for this column,[1] Caroline D. Ciraolo, the Acting Assistant Attorney General for the Tax Division of the Department of Justice, described the division's continuing pursuit of individuals believed to have evaded their U.S. tax obligations through offshore accounts. Among other things, Ciraolo noted that, in the wake of the Justice Department's Program for Non-Prosecution Agreements or Non-Target Letters for Swiss Banks, the Tax Division's civil trial attorneys were seeking to enforce Bank of Nova Scotia summonses to obtain information regarding previously undisclosed offshore assets.

Through Bank of Nova Scotia summonses, the Internal Revenue Service (IRS) seeks to compel U.S. branches of foreign banks to produce records held by their overseas branches, even when production would otherwise be proscribed by foreign bank secrecy laws. While this law enforcement tool has been available since the early 1980s, it appears to have been used rarely over the past three decades. In today's regulatory climate, however, practitioners representing taxpayers need to be aware of the availability of Bank of Nova Scotia summonses to expand the government's jurisdictional reach, as well as potential limitations on the use of such summonses.

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Bank of Nova Scotia Case

In *In re Grand Jury Proceedings* (*Bank of Nova Scotia*),[2] a grand jury subpoena seeking documents located in the Bahamas was served on the Bank of Nova Scotia's Miami agency office in connection with an investigation of narcotics trafficking and tax evasion. The district court rejected the bank's arguments that Bahamian law barred production of client records without consent and enforced the subpoena. The bank refused to comply, leading the district court to find it in contempt.

On appeal to the U.S. Court of Appeals for the Eleventh Circuit, the bank argued that the subpoena (1) sought materials that were not sufficiently relevant to the grand jury's investigation, (2) violated the bank's due process rights, and (3) offended principles of international comity. In rejecting these arguments, the court concluded that a grand jury subpoena must be met with a good-faith effort to comply, and that the bank could not rely solely on Bahamian law to justify non-compliance. Specifically, the court declined to require the government to prove the relevance or importance of the subpoenaed documents, holding that doing so would impose "undue restrictions upon the grand jury investigative process pursuant to [its] supervisory power."[3]

The court also ruled that the bank's due process rights were not infringed by the enforcement of the subpoena, noting that "it seems hardly offensive to 'traditional notions of fair play and substantial justice' to subject entities who do business in the United States and thereby voluntarily bring themselves within the jurisdiction of our courts and legislatures to the burdens of United States law."[4]

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Finally, in assessing whether comity between nations would permit enforcement of the subpoena, the court approved a balancing test enumerated in the Restatement (Second) of Foreign Relations Law of the United States[5] and adopted by the U.S. Court of Appeals for the Fifth Circuit in *United States v. Field*.[6] As in *Field*, the Eleventh Circuit concluded that the United States' interests in the investigative function of the grand jury and the collection of revenue outweigh the interests of foreign bank secrecy, noting that the Bahamian bank secrecy statute was "hardly a blanket guarantee of privacy."[7]

Implications

Since the Bank of Nova Scotia decision,[8] the Eleventh Circuit's holding has not been seriously questioned or relitigated. While courts have occasionally considered challenges to other subpoenas that mandated contravention of foreign bank secrecy laws, they have "consistently [held] that the United States' interest in law enforcement outweighs the interests of the foreign states in bank secrecy and the hardships imposed on the entity subject to compliance."[9]

Indeed, the two cases that refused to follow *Bank of Nova Scotia* were distinguishable. In *In re Sealed Case*, the U.S. Court of Appeals for the D.C. Circuit reversed an order holding a bank owned by a foreign sovereign in contempt for refusing to comply with a grand jury subpoena ordering it to provide records held in a country with strict bank secrecy laws. In contrast to the Bank of Nova Scotia case, the government conceded that it would have been impossible for the bank to comply with the subpoena without violating foreign law, and the district court found that the bank had acted in good faith. The D.C. Circuit declined to "decide the general issue of whether a court may ever order action in violation of foreign laws," but instead refused to uphold the contempt citation under the circumstances presented.[10]

The court distinguished *Bank of Nova Scotia*, noting that the Eleventh Circuit had upheld a contempt order against an entity located in the United States, rather than a foreign sovereign itself, and that "there was considerable room for doubt whether enforcement of the order would require violation of foreign laws on foreign soil."[11] Ultimately, the D.C. Circuit noted that it caused "considerable discomfort" to contemplate ordering the violation of another sovereign's laws, but reaffirmed "the proposition that the vital role of grand jury investigations in our criminal system endows the grand jury with wide discretion in seeking evidence."[12]

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Similarly, in *United States v. First National Bank of Chicago*, the U.S. Court of Appeals for the Seventh Circuit reversed an order holding a Greek bank in contempt for failing to comply with an IRS summons for records protected by foreign bank secrecy. In doing so, the court noted that the district court had neither engaged in the balancing inquiry adopted by the Eleventh Circuit in *Bank of Nova Scotia* nor assessed whether the Greek bank had failed to make a good-faith effort to comply with the summons.[13]

Significantly, the court distinguished *Bank of Nova Scotia* on the grounds that "[t]he information [in *Bank of Nova Scotia*] was sought by a grand jury conducting a tax and narcotics investigation, so that the interest of the United States in the grand jury process of investigation and enforcement of its criminal laws was involved as well as its interest in determination and collection of taxes."[14]

'United States v. UBS'

While *Bank of Nova Scotia* authorized the use of grand jury subpoenas to obtain foreign records, the IRS and Justice Department clearly contemplate using administrative summonses to target suspected tax evaders with accounts that would otherwise be protected by bank secrecy laws.[15] Indeed, earlier this year, the Justice Department sought to enforce a summons that the IRS had served on the Miami branch of UBS seeking records from its Singapore branch.[16]

In its petition to enforce the summons, the government argued that regardless of bank secrecy laws, "international comity requires that the [summoned] records be disclosed."[17] Without citing *Bank of Nova Scotia*, the petition focused on the standard for enforcing an IRS summons set forth by the U.S. Supreme Court in *United States v. Powell*—that the summons is: issued for a legitimate purpose, seeks information relevant for that purpose that is not already within the possession of the IRS, and has satisfied all of

the steps required under the Internal Revenue Code.[18]

While UBS has yet to respond to the government's petition, the Justice Department has anticipated that the bank will argue that Singapore law prohibits disclosure of its records without the client's consent.[19] It remains to be seen, however, whether UBS will also argue that *Bank of Nova Scotia* was predicated on the government interests at stake in a grand jury investigation, and that the competing interest of international comity is entitled to greater weight in the context of an administrative summons.

Looking Forward

Assuming the government's faith in its authority to issue summonses under *Bank of Nova Scotia* is sound, one can expect such summonses to take on new prominence as the Justice Department shifts its tax enforcement focus beyond Switzerland. Each of the 80 banks that obtained non-prosecution agreements through the Swiss Bank Program provided the Justice Department with a "leaver list" containing information regarding U.S.-related accounts that were closed after August 2008, including information regarding the disposition of the funds in the account. The government is already actively pursuing investigations around the world, and the Eleventh Circuit's decision in *Bank of Nova Scotia* provides the government with a powerful tool to identify the account holder and assess his or her tax compliance.

In the coming years, the Foreign Account Tax Compliance Act (FATCA) will enable the United States to track assets held by U.S. persons abroad. With respect to accounts closed before FATCA's implementation and accounts held in jurisdictions that have not implemented FATCA, however, the IRS may continue to use Bank of Nova Scotia summonses to obtain information otherwise protected by bank secrecy laws.

U.S. persons with undisclosed assets abroad should take no comfort in having avoided the Justice Department's efforts in Switzerland. As Acting Assistant AG Ciraolo has cautioned, "[t]hose who continue to fail to come forward and disclose their conduct run the very serious risk of ending up as the next criminal defendant or at the receiving end of a substantial assessment of civil penalties."[20]

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1. Jeremy Temkin, "DOJ Tax Division Today: Interview with Acting Assistant AG," NYLJ (March 23, 2016).

2. 691 F.2d 1384 (11th Cir. 1982).

3. Id. at 1387.

4. Id. at 1391 n. 6 (internal citations omitted).

5. The Restatement provides:

> Where two states have jurisdiction to prescribe and enforce rules of law and the rules they may prescribe require inconsistent conduct upon the part of a person, each state is required by international law to consider, in good faith, moderating the exercise of its enforcement jurisdiction, in the light of such factors as
>
> (a) vital national interests of each of the states,
>
> (b) the extent and the nature of the hardship that inconsistent enforcement actions would impose upon the person,
>
> (c) the extent to which the required conduct is to take place in the territory of the other state,
>
> (d) the nationality of the person, and
>
> (e) the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by that state.

Restatement (Second) of Foreign Relations Law §40 (1965).

6. 532 F.2d 404 (5th Cir. 1976), cert. denied, 429 U.S. 940 (1976). Following the Eleventh Circuit's establishment and split from the Fifth Circuit on Oct. 1, 1981, the new court adopted as binding precedent all decisions of the Fifth Circuit handed down prior to that date. *Bonner v. City of Prichard*, 661 F.2d 1206, 1209 (11th Cir. 1981) (en banc).

7. *Bank of Nova Scotia*, 691 F.2d at 1391 (quoting *United States v. Payner*, 447 U.S. 727, 731 n. 4 (1980)).

8. Subsequently, the Miami branch of the Bank of Nova Scotia was served with a similar grand jury subpoena seeking additional records located in the bank's offices in the Bahamas, Cayman Islands, and Lesser Antilles. The bank again resisted production, and was again held in contempt. Over the objection of amici, including the governments of Canada, the United Kingdom, and the Cayman Islands, the Eleventh Circuit concluded on appeal that the United States' interest in enforcing its grand jury subpoenas outweighed the competing interests of the bank and other nations in maintaining bank secrecy. *In re Grand Jury Proceedings*, 740 F.2d 817, 829 (11th Cir. 1984).

9. *In re Grand Jury Subpoena dated Aug. 9, 2000*, 218 F.Supp.2d 544, 554 (S.D.N.Y. 2002) (collecting cases in a non-tax context).

10. 825 F.2d 494, 498-99 (D.C. Cir. 1987).

11. Id. at 498.

12. Id. at 498-99.

13. 699 F.2d 341, 345-47 (7th Cir. 1983).

14. 699 F.2d at 347.

15. See Internal Revenue Service, Internal Revenue Manual §34.6.3.7, Issuance of Summons for Books and Records Abroad, available at https://www.irs.gov/irm/part34/irm_34-006-003.html; Department of Justice Tax Divisions, Summons Enforcement Manual at 74, available at https://www.justice.gov/sites/default/files/tax/legacy/2011/08/31/SumEnfMan_July2011.pdf ("Summonses to entities located in the United States for records located abroad").

16. *United States v. UBS*, No. 1:16-mc-20653 (S.D. Fla.).

17. Petition to Enforce IRS Administrative Summons at ¶17, *United States v. UBS*, No. 1:16-mc-20653 (S.D. Fla. Feb 23, 2016).

18. 379 U.S. 48, 57-59 (1964).

19. Petition to Enforce IRS Administrative Summons at ¶14, *United States v. UBS*, No. 1:16-mc-20653 (S.D. Fla. Feb 23, 2016). For its part, Singapore has signaled that its bank secrecy laws will not protect criminal activity and that it is willing to cooperate with foreign investigations. Thus, Singapore seems unlikely to take steps to impede the enforcement of the summons. See David Voreacos, "Is Singapore the Next Switzerland for U.S. Tax Crackdown?," Bloomberg, March 3, 2016, available at http://www.bloomberg.com/news/articles/2016-03-03/singapore-banking-secrecy-makes-ripe-target-for-irs.

20. See "Acting Assistant Attorney General Caroline D. Ciraolo Delivers Remarks at the Federal Bar Association Tax Law Conference, Department of Justice," March 4, 2016, available at https://www.justice.gov/opa/speech/acting-assistant-attorney-general-caroline-d-ciraolo-delivers-remarks-federal-bar.