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TAX LITIGATION ISSUES

Expert Analysis

Another Catch-22 For Swiss Accountholders

In recent months, at least one Swiss bank has sent letters notifying its U.S. customers that the Internal Revenue Service has submitted a request to the Swiss Federal Tax Administration (SFTA) seeking account records pursuant to a 1996 Convention between the United States and Switzerland. Those letters further notify the recipients that, while they will have the right to appeal any decision by SFTA authorizing disclosure of their account records, under U.S. law, they will have to provide a copy of the papers filed in Switzerland to the U.S. Department of Justice.

This requirement, which ap-pears in 18 U.S.C. §3506, was adopted as a means of preventing targets and defendants from using overseas litigation to thwart criminal prosecution in the United States. Unlike other cases where it comes into play, however, compliance with §3506 in the context of a previously undisclosed offshore account will provide the government with the very information being sought: the accountholder's identity. As a result, taxpayers subject to potential disclosure of their accounts face three problematic choices: forgoing litigation in Switzerland; complying with §3506, thereby rendering their appeals moot, or violating their obligation to notify the Justice Department of their appeals. Through its recent pronouncements, the Justice Department has suggested that taxpayers—and their advisers—choose the third course at their peril.

By **Jeremy H. Temkin**

Section 3506

As criminal law enforcement becomes increasingly international in scope, the U.S. government is more frequently seeking evidence from foreign courts, either during investigations or post-indictment. Because many foreign jurisdictions give the targets of such investigations the ability to oppose the production of the requested evidence, prosecutors have often faced "delays caused by criminal defendants' use of foreign procedures to block prosecutors' requests for records."[1]

In connection with the Comprehensive Crime Control Act of 1984 (CCCA), Congress recognized that procedures for gathering evidence in foreign countries "frequently permit the defendant to contest the United States prosecutor's request for the records, and often involve several levels of review." Congress went on to note that defendants often sought to block compliance with the request for the records by initiating legal proceedings without notice to the U.S. government, and "[i]n such a circumstance, the United States prosecutor may be unable to respond to the foreign action in a timely manner, forced to delay seeking an indictment, or compelled to seek a continuance in a pending criminal case."[2]

> The government's aggressive position with respect to §3506 presents difficult issues for both the accountholders and their advisers.

To address this perceived problem, Congress adopted §3506(a), which requires "any national or resident of the United States who submits, or causes to be submitted, a pleading or other document to a court or other authority in a foreign country in opposition to an official request for evidence of an offense shall serve such pleading or other document on the Attorney General at the time such pleading or other document is submitted."[3] Where the U.S. government's request is made post-indictment, §3506(b) requires "[a] ny person who is a party to a criminal proceeding" in the United States to serve any opposition to the government's request for foreign assistance on the prosecutor in the underlying criminal case.[4] Significantly, §3506 appears in the chapter of Title 18 that addresses "Witnesses and Evidence" and does not contain any sanction for non-compliance.

The Case Law

In *Poe v. Attorney General*,[5] an anonymous plaintiff faced a request for records that the U.S. government had made in Switzerland. The plaintiff challenged the constitutionality of §3506, arguing that compliance "would require disclosure of his identity, the fact that he is objecting to the request, and other facts protected from disclosure by Swiss law." While the statute requires disclosure at the time the documents are filed, Judge Harold Greene of the U.S. District Court for the District of Columbia noted that, "[t]o enforce [§3506], the government must discover the identity of the person opposing the United States' request for assistance and then seek a court order directing that individual to comply with the notice and filing provisions of the statute."

Because the statute's validity would be litigated in that context, "at no time will plaintiff confront the dilemma of complying with an allegedly invalid law or risking civil or criminal penalties for failure to do so." Judge Greene further noted, however, that given uncertainty "about the applicability and constitutionality of section 3506," the plaintiff was forced to decide "whether to file a thorough opposition to the United States' request for assistance with the risk that the Attorney General will obtain a copy of that pleading through an enforcement action, or whether to restrict or forego entirely the exercise of his right to oppose the request for assistance." Given the passage of time since the complaint was filed, Judge Greene avoided deciding whether Poe's challenge was ripe by asking the parties to brief whether the issue was moot.

In *Fraser v. United States*,[6] the government brought an action to compel Paul Sherwood Fraser to provide it with a copy of papers he had filed in Switzerland opposing its request for certain bank records. On appeal from an order directing Fraser to comply with §3506, the U.S. Court of Appeals for the Eleventh Circuit noted "that Congress intended Section 3506(a) to function as an evidence-gathering, discovery device in a criminal case," and thus

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that an order granting the government's request "is akin to a grant of a motion to compel discovery in a criminal proceeding." Rather than addressing Fraser's challenge on the merits, the court concluded that the order requiring him to produce the opposition filed in Switzerland was an interlocutory non-appealable order and that "Fraser's recourse is to disobey the order and challenge the order once the district court finds him in contempt."

Finally, in *United States v. Marcos*,[7] the government sought a post-indictment order directing Imelda Marcos to provide copies of documents she had submitted in various countries in opposition to the government's requests for evidence. As in *Fraser*, the government was already aware that Marcos had opposed its overseas discovery requests and sought a copy of her opposition papers. After rejecting several other challenges, Judge John F. Keenan of the U.S. District Court for the Southern District of New York addressed Marcos' Fifth Amendment claim. After concluding that Marcos had "not contended that she prepared any litigation papers filed with foreign officials involuntarily," and thus that the necessary element of compulsion was lacking, Judge Keenan held that Marcos' foreign litigation papers might be entitled to protection under the "Act of Production" doctrine if she could establish "that 'the testimonial implications of [her] production of the documents…might tend to incriminate [her].'"[8]

Swiss Accountholders

In light of this case law, U.S. taxpayers whose Swiss bank accounts are subject to disclosure must choose between (a) forgoing their right to appeal in Switzerland; (b) pursuing an appeal in Switzerland and comply with §3506, which would render their Swiss appeal moot[9]; and (c) pursuing their appeal, without complying with their obligations under §3506. While Congress did not specify any civil or criminal penalty for non-compliance with §3506,[10] and while the courts in *Poe*, *Fraser* and *Marcos* all assumed that compliance with §3506 would be litigated after the government knew the identity of the person who filed the objection to discovery abroad, the Justice Department has suggested that it may consider a taxpayer's failure to comply with §3506 as affirmative evidence of a conspiracy to commit tax evasion, which includes the taxpayer's counsel.[11] Moreover, the Justice Department has referred attorneys representing taxpayers who fail to comply with §3506 to the IRS's Office of Professional Responsibility for possible disciplinary action,[12]

And, unlike the plaintiff in *Poe*, no matter how narrowly a taxpayer draws his appellate papers in Switzerland, simply disclosing that he has appealed an order by SFTA directing disclosure of a Swiss bank account will put a taxpayer in jeopardy. Armed with the knowledge that a taxpayer filed an appeal in Switzerland, the Justice Department will almost certainly serve a subpoena on that taxpayer seeking information regarding that account.[13]

Available Options

Under the circumstances, taxpayers and their professionals who believe they have valid challenges to the production of their account information have limited options. By threatening to treat the failure to comply with §3506 as an affirmative act of evasion—and to refer practitioners whose clients do not comply with §3506 to OPR—the Justice Department is attempting to punish conduct despite the absence of any sanction set forth by Congress. While the Justice Department's position is inconsistent with the case law suggesting that taxpayers can litigate their obligations under §3506 in the context of a motion by the government to compel production of the foreign filings, taxpayers and their advisers may want to consider litigating the taxpayer's obligations under that statute proactively.

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In challenging the applicability of §3506, a taxpayer could argue that the U.S. court should refuse to mandate immediate disclosure of his Swiss pleadings because compliance will effectively negate his appellate rights afforded under Swiss law. In this regard, the taxpayer's position is supported by §474 of the Restatement (Third) of Foreign Relations, which provides that "[w]hen the law of the state where the evidence is located grants interested persons the right to make a submission in opposition to disclosure, it would not ordinarily be appropriate for the U.S. court to enjoin such submission or to impose sanctions on a person who has availed himself of that right."[14] Indeed, in *Marcos*, the government carved the Swiss records out of its request when the Justice Department's Office of International Affairs concluded that its motion to compel production of Marcos' Swiss pleadings "would likely impair the Government's ability to receive the Swiss documents sought pursuant to" its treaty request.[15] A taxpayer may also argue, as did the plaintiff in *Poe*, that immediate disclosure would unfairly limit his right under Swiss law to keep his appellate pleadings confidential.[16]

Conclusion

U.S. taxpayers with Swiss accounts remain in the Justice Department's cross hairs. The government's aggressive position with respect to §3506 presents difficult issues for both the accountholders and their advisers. While the case law supports the notion that §3506 is a discovery device, which should be resolved through a motion by the government to compel production of such filings, the plain language of the statute and recent pronouncements by the government suggest that taxpayers and their advisers defer resolving the issue at their peril.

A Final Word

Robert G. Morvillo passed away on Dec. 24, 2011. Bob was a great lawyer and a pioneer in the white collar bar. He was also a great partner, mentor and friend. He is and will be missed by his partners and colleagues.

1. See *United States v. Davis*, 767 F.2d 1025, 2038 (2d Cir. 1985).
2. See H.R. REP. NO. 98-907, at 3578-79 (1984).
3. An official request is defined as "a letter rogatory, a request under a treaty or convention, or any other request for evidence made by a court of the United States or an authority of the United States having criminal law enforcement responsibility, to a court or other authority of a foreign country." 18 U.S.C. §3506(c).
4. In connection with the CCCA, Congress also eased the requirements for introducing foreign business records, see 18 U.S.C. §3505, authorized the appointment of a special master when taking depositions abroad, see id. §3507, tolled the statute of limitations while the government seeks evidence abroad, see id. §3292, and tolled the Speedy Trial Act during the pendency of evidence gathering procedures, see id. §3161(h)(9).
5. No. 86-cv-1449, 1987 WL 17061 (D.D.C. Sept. 4, 1987).
6. 834 F.2d 911 (11th Cir. 1987).
7. No. 87-cr-598, 1989 WL 135256 (S.D.N.Y. Oct. 31, 1989).
8. *Marcos*, 1989 WL 135256, at *5 (quoting *In re Sealed Case*, 832 F.2d 1268, 1270 (D.C. Cir. 1987)).
9. While the Offshore Voluntary Disclosure Initiative (the "OVDI") closed on Sept. 9, 2011, the IRS's Voluntary Disclosure Practice remains open to eligible taxpayers who come forward with previously undisclosed offshore accounts. Such taxpayers will not, however, have the certainty regarding the civil penalty structure that was offered to successful participants in the OVDI.
10. See *Poe*, No. 86-cv-1449, 1987 WL 1706, at *1 ("violation of section 3506 does not carry a civil or criminal penalty").
11. See Joseph M. Erwin, "The Developing Aftermath of the UBS Affair: A New Tax Order," International Tax Monitor (August 2010), http://www.bnai.com/UBSAffairAftermath/default.aspx.
12. See 2010 Tax Notes 44-4, Practitioners Handling Offshore Account Cases Warned About Sanctions for Nondisclosure (March 8, 2010).
13. See Jeremy H. Temkin, "Fifth Amendment and Government's War on Offshore Accounts," New York Law Journal (Nov. 12, 2011).
14. According to Stefan Treschel (a professor, an international judge, and the former president of the European Commission of Human Rights), §3506 "is at variance with Swiss law, which under article 37(2) of the Treaty is an exclusive remedy. …Hence, the Swiss authorities have expressed their expectation that the United States provision will be applied in a manner that does not render it incompatible with the Treaty." Lionel Frei & Stefan Trechsel, Origins and Applications of the United States-Switzerland Treaty on Mutual Assistance in Criminal Matters, 31 HARV. INT'L L. J. 77, 90 (1990).
15. See id. At 1, n.2; accord Thomas Cottier & René Matteotti, The Treaty Request Agreement between the Swiss Confederation and the United States of America of Aug. 19, 2009 (UBS Agreement): Principles and Domestic Applicability, Legal Opinion for the (Swiss) Federal Office of Justice, Oct. 31, 2009 ("An obligation on the part of the client to inform the IRS would nullify appeal proceedings. For that reason, from the Swiss perspective it cannot be considered until those proceedings have been closed").
16. See Plaintiff's Memorandum Regarding Mootness and Ripeness, *Poe v. Attorney General*, No. 86-CV-1449, 1986 WL 1241983 at 1, 7-8 (D. D.C. Sept. 22, 1987).