New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
VOLUME 250—NO. 83
MONDAY, OCTOBER 28, 2013

TAX LITIGATION ISSUES

Expert Analysis

New Justice Department-Swiss Bank Program Announced

Since 2008, the Department of Justice and Internal Revenue Service have targeted the use of undisclosed offshore accounts to evade U.S. income taxes: entering into a Deferred Prosecution Agreement with UBS AG and a non-prosecution agreement with Liechtensteinische Landesbank AG; prosecuting a second Swiss bank, Wegelin & Co.; and bringing criminal charges against more than 100 taxpayers, bankers, and other professionals.

Since March 2009, the IRS has also offered a series of Voluntary Disclosure programs aimed at enticing taxpayers to come forward and disclose their offshore accounts. These programs combined the offer of protection from criminal charges with a settlement initiative that gave participants certainty regarding the financial penalties they would pay to rectify their past violations. To date, over 39,000 taxpayers have participated in the Offshore Voluntary Disclosure Program of 2009, the Offshore Voluntary Disclosure Initiative of 2011, and the Offshore Voluntary Disclosure Program of 2012, paying over $5.5 billion in taxes, interest and penalties in exchange for assurances they would not be prosecuted.[1]

On Aug. 29, 2013, the Justice Department announced a new Program for Non-Prosecution Agreements or Non-Target Letters for Swiss Banks,[2] which is designed to enable Swiss banks to resolve their own exposure to criminal charges. The program represents an important new phase in the government's long-running battle against undisclosed offshore accounts and is likely to generate a new round of voluntary disclosures by taxpayers encouraged by Swiss banks to bring their accounts into compliance with U.S. reporting requirements.

By **Jeremy H. Temkin**

The Program's Provisions

The program divides Swiss banks into four categories: approximately 14 banks that were under criminal investigation prior to Aug. 29, 2013 (Category 1 banks); banks that have "reason to believe [they] may have committed tax-related offenses…or monetary transactions offenses…in connection with undeclared U.S. Related Accounts" during the "Applicable Period" (Category 2 banks);[3] banks that have "not committed any" violations of the applicable statutes after Aug. 1, 2008 (Category 3 banks); and banks that qualify as "Financial Institution[s] with Local Client Base" under the U.S.-Swiss agreement implementing the Foreign Account Tax Compliance Act (FATCA) (Category 4 banks). Not surprisingly, Category 1 banks are precluded from participating in the program and will have to resolve the already-pending investigations without the leniency it provides. By contrast, participating Category 2 banks complying with the program's requirements will be rewarded with Non-Prosecution Agreements (NPAs), while Category 3 and 4 banks are eligible for "non-target letters."

Category 2 Banks. The program provides for a moratorium on new criminal investigations of additional Swiss banks until Jan. 1, 2014.[4] Category 2 banks must inform the Justice Department of their intent to participate in the program by Dec. 31, 2013, and must comply with the program's requirements within 120 days of notifying the Justice Department of their intent to participate, although the department will provide a 60-day extension "upon a showing of good cause."[5]

To qualify for an NPA, a Category 2 bank must disclose information regarding its cross-border business for U.S. Related Accounts, including details regarding the internal supervision of that business, the identity and roles of individuals involved in it, how the bank attracted and serviced account holders, and the total number and aggregate maximum balance of the U.S. Related Accounts that (a) existed on Aug. 1, 2008, (b) were opened between Aug. 1,

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2008, and Feb. 28, 2009, and (c) were opened after Feb. 28, 2009.[6]

Upon execution of an NPA, a Category 2 bank will also be required to disclose the total number of U.S. Related Accounts closed after Aug. 1, 2008; the maximum value of those accounts during the Applicable Period; the number of U.S. persons or entities associated with each account, whether the account was held in the name of an individual or entity, and whether it held U.S. securities; the identity and function of third-party service providers; and information regarding transfers into and out of the account during the applicable period.[7] Category 2 banks must retain an attorney or accountant to serve as an Independent Examiner and both verify this information and confirm that the bank used specified due diligence standards in gathering it.[8]

Category 2 banks must agree to provide the Justice Department with information necessary to draft treaty requests and to collect and maintain records to enable them to respond to such requests promptly. They must also retain certain records for a period of 10 years following the conclusion of their NPA; provide witnesses or information necessary to enable the Justice Department to use the information and evidence obtained—through either the program or a separate treaty request—in future proceedings; close accounts of "recalcitrant account holders" and take steps to prevent those individuals from further concealing their funds; and not open any new accounts except under conditions designed to ensure that they will be declared in the United States.[9]

Finally, Category 2 banks will be required to pay a penalty at a rate predicated on when accounts were opened: 20 percent of the highest balance of accounts that existed before Aug. 1, 2008, 30 percent of the maximum balance of accounts opened between Aug. 1, 2008, and Feb. 28, 2009, and 50 percent of accounts opened after Feb. 28, 2009.[10] By staggering the penalties in this way, the Justice Department is sanctioning so-called "leaver banks" that took on clients who closed accounts at UBS and other large banks as the Justice Department's investigation became public.

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A Category 2 bank can, however, reduce its penalty by demonstrating to the Justice Department's satisfaction (a) that individual U.S. Related Accounts had been declared; (b) that it disclosed such accounts to the IRS; or (c) that an account holder disclosed an account through an Offshore Voluntary Disclosure Program or Initiative "following notification by the [bank] of such program or initiative and prior to the execution of the NPA."[11]

Category 3 and 4 Banks. Banks that did not violate U.S. tax or monetary transaction laws are eligible for "non-target letters" as Category 3 banks, and banks that had de minimus business with U.S.-based clients can obtain such letters as Category 4 banks. Such banks are required to notify the Justice Department of their intent to participate in the program between July 1, 2014, and Oct. 31, 2014.[12]

In order to obtain a non-target letter, a Category 3 bank must retain an Independent Examiner to conduct an internal investigation aimed at confirming that the bank has not committed any tax or monetary transaction violations. At the end of the investigation, the Independent Examiner will be required to (a) verify the extent of the bank's U.S. Related Accounts; (b) describe the bank's compliance program and verify that it is "effective"; and (c) provide the Justice Department with a report of her investigation, including details regarding its scope and her factual findings and conclusion.[13]

Like Category 2 banks, Category 3 banks must agree to maintain documents relating to the Independent Examiner's investigation, to close accounts of "recalcitrant account holders," to take steps to prevent those individuals from continuing to conceal their funds, and not to open any new accounts except under conditions designed to ensure that they will be declared in the United States.[14] Even after issuing a non-target letter, the Justice Department reserves the right to pursue criminal charges against a Category 3 bank if, in its sole discretion, it determines that the bank "provided materially false, incomplete, or misleading information or evidence…, or has otherwise materially violated the terms of any agreement with the United States."[15]

In order to participate under Category 4, a bank must establish that it qualified as a "Financial Institution with a Local Client Base" under the U.S.-Swiss FATCA Agreement on both Dec. 31, 2009, and Aug. 29, 2013. To do so, a bank must demonstrate the limited extent of its cross-border business, and the Independent Examiner for such a bank is only required to verify that it satisfies the relevant criteria.[16]

The Dilemma for Banks

Swiss banks and their professional advisors must assess the pros and cons of participating in the program and whether to pursue Category 2, 3 or 4. In evaluating its exposure to prosecution in the United States, a bank must consider not only the risk that its U.S. account holders have disclosed (or will disclose) the bank's complicity in their criminal acts through one of the IRS's voluntary disclosure programs, but

also the danger that other participating banks will disclose that they received client assets from or transferred client assets to the bank.

For banks concluding that they have criminal exposure, the program provides an opportunity to extinguish their potential liability, albeit by incurring a substantial financial penalty. Moreover, participating banks will have to disclose the misconduct of employees and other third parties.[17] While Category 3 and 4 banks will not have the same potential exposure, they may conclude that the professional fees associated with participating in the program are more than outweighed by both the clarity it offers regarding their criminal liability and the possible competitive advantage a "non-target letter" may provide in the future.

By defining Category 3 banks as those that "have not" engaged in misconduct, the Justice Department has set a high threshold for such a designation, effectively pushing banks to participate under Category 2, despite the possible stigma attached to an NPA as opposed to a "non-target letter." Moreover, because the deadline for declaring an intent to participate under Category 2 is Dec. 31, 2013, i.e., the final day of the moratorium on new criminal investigations and six months before banks can claim Category 3 designation, the program places a premium on promptly (and correctly) assessing the bank's exposure. While the Justice Department may grant relief to a bank that belatedly determines that it does not qualify as a Category 3 bank,[18] banks that fail to identify violations before Dec. 31, 2013, may find themselves excluded from the program.

Account Holders

The program reflects a major step forward for the government's fight against offshore accounts. In a joint release announcing the program, the Justice Department and the Swiss Federal Department of Finance made clear that Switzerland intends to encourage Swiss banks to participate.[19] While the program does not provide for disclosure of account-specific information (including the identity of account holders), the Justice Department clearly intends to use the information provided to request details pursuant to applicable treaties, and banks will be required to comply with such treaty requests under their NPAs.

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The joint release further noted that the Swiss Financial Market Supervisory Authority (FINMA) will be encouraging Swiss banks to send letters to U.S. account holders informing them of both the program and the OVDP. Indeed, the program rewards Category 2 banks by excluding from their penalty calculations accounts that are disclosed through the OVDP after the bank notifies its account holders of the ability to make a voluntary disclosure. The fact that participating banks will be precluded from helping non-compliant customers conceal their funds elsewhere and the upcoming implementation of FATCA will put additional pressure on account holders to come into compliance.

Conclusion

For the past five years, tax professionals have been consulting clients on issues relating to previously undisclosed offshore accounts, including the costs and benefits of participating in the voluntary disclosure programs offered by the IRS. The new Justice Department Program for Non-Prosecution Agreements or Non-Target Letters for Swiss Banks will increase account holder awareness of the current OVDP and incentivize taxpayers to come forward and participate. Moreover, while the government's present focus is on accounts at Swiss banks, the program is likely to serve as a template for the Justice Department's compliance efforts with respect to banks in other jurisdictions.

1. See Government Accountability Office, Offshore Tax Evasion—IRS Has Collected Billions of Dollars, but May Be Missing Continued Evasion (March 2013), available at http://www.gao.gov/assets/660/653369.pdf.

2. See http://www.justice.gov/iso/opa/resources/859201382916421323559 9.pdf.

3. Program, ¶II.A.3. As defined in ¶I.B.9., "U.S. Related Accounts" are "accounts which exceeded $50,000 in value at any time during the Applicable Period…as to which indicia exist that a U.S. Person or Entity has or had a financial or beneficial interest in, ownership of, or signature authority (whether direct or indirect) or other authority…over the account," as determined by applying the due diligence procedures set forth in the U.S.-Swiss agreement implementing FATCA. The "Applicable Period" is defined at ¶I.B.6.; in most cases it will be the period between Aug. 1, 2008, and the later of the date of a Non-Prosecution Agreement or Non-Target Letter issued under the program or Dec. 31, 2014.

4. Id., ¶V.A.

5. Id., ¶II.B.

6. Id., ¶II.D.1.

7. Id., ¶II.D.2.

8. Id., ¶II.D.3. The Justice Department "reserves the right to object to a particular attorney or accountant, but will not unreasonably withhold approval." Id., ¶I.B.10.

9. Id., ¶¶II.D.4.-II.D.5., II.E.-II.G.

10. Id., ¶II.H.

11. Id.

12. Id., ¶¶III.B.; IV.B.

13. Id., ¶III.D., III.E.

14. Id., ¶III.F.

15. Id., ¶III.F.4.

16. See id., ¶IV.A.2.

17. The press release announcing the program notes that counsel for "bank employees who are concerned about whether they have potential criminal liability should contact [the Justice Department] if they wish to seek a resolution." See http://www.justice.gov/tax/2013/txdv13975.htm.

18. Program, ¶III.C.

19. See http://www.justice.gov/iso/opa/resources/859201382916421323559 9.pdf.