

## TAX LITIGATION ISSUES

## Expert Analysis

# Congress Weighs In On Offshore Enforcement

In recent years, through both traditional means and innovative non-prosecution initiatives, the Internal Revenue Service and the Department of Justice have made substantial contributions to the public fisc, even while underfunded by a largely gridlocked Congress. Yet in a highly publicized report and subsequent hearings, the U.S. Senate Permanent Subcommittee on Investigations (PSI Report) recently accused the IRS and the Justice Department of not adequately investigating or prosecuting offshore accountholders and foreign banks.

There is a fundamental disconnect between this bipartisan view and the experience of many practitioners representing clients affected by initiatives instituted by both the IRS and the Justice Department. Rather, the criticisms lodged in the PSI Report understate significant limitations on the Executive Branch's ability to pursue investigations in foreign jurisdictions such as Switzerland, including practical considerations of comity and sovereignty and budgetary constraints. Indeed, it could be fairly argued that Congress could help further fair and effective enforcement by fully funding both the IRS and the Justice Department and by ratifying a recently negotiated treaty that could provide law enforcement with access to Swiss banking records.

### Enforcement Statistics

The resources available to the Justice Department have declined significantly in recent years. On Feb. 10, Attorney General Eric Holder announced that a three-year hiring freeze, which had caused the Justice Department to lose more than 4,000 employees, was being lifted and that the recent bipartisan budget agreement would restore the Justice Department's funding to pre-sequestration levels.<sup>1</sup> While the Justice Department will now be able to "resume the normal hiring process [in order] to fulfill [its] mission,"<sup>2</sup> according to a press release issued on Feb. 11

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by the U.S. Attorney's Office for the Southern District of New York, investigations and prosecutions nationwide in fiscal year 2013 resulted in "approximately \$5.9 billion [being] collected by the Justice Department" in civil actions, and the department also collected "approximately \$2.2 billion in restitution, criminal fines, and felony assessments in criminal actions."<sup>3</sup> The Southern District U.S. Attorney's office press release added that despite a 13 percent vacancy rate for assistant U.S. attorneys and 26 percent vacancy rate for staff since January 2013, actions brought by prosecutors in that office have resulted in the recovery of (or agreements to recover) nearly \$4 billion through civil and criminal penalties and asset forfeiture.<sup>4</sup> This corresponds to an almost 8,000 percent return on investment for the federal government (and its taxpayers), i.e., nearly 80 times the office's annual budget.<sup>5</sup>

Similarly, on Feb. 24, 2014, IRS Criminal Investigation released its Annual Business Report for the fiscal year ending Sept. 30, 2013,<sup>6</sup> which noted that despite a significant decline in available resources, the IRS opened and prosecuted far more cases last year than it had in recent years. According to the report, the Criminal Investigation unit commenced 12.5 percent more investigations in fiscal year 2013 than it did in 2012, and recommended 18 percent more cases for prosecution.<sup>7</sup> Yet, at the same time, staffing levels were down noticeably: the IRS had 5.4 percent fewer special agents in 2013 than in 2012, and nearly 10 percent fewer than it had at the end of fiscal year 2009, when staffing levels were last increased.<sup>8</sup> These increases are mirrored in the

nationwide number of criminal tax prosecutions: In fiscal year 2012, 605 defendants were sentenced in cases in which a tax violation was the primary offense, compared with 480 in 2003.<sup>9</sup> And the Justice Department instituted 658 tax fraud cases in fiscal year 2012, compared with 529 in 2003.<sup>10</sup>

### Offshore Account Initiatives

Over the past five years, the IRS and Justice Department have been especially active in pursuing taxpayers who concealed assets in offshore bank accounts and the bankers and other professionals who enabled their conduct. Since 2009, the Justice Department has charged at least 134 individuals in offshore account cases, obtaining convictions in all but one of the cases brought to conclusion.<sup>11</sup> In addition, the IRS has run three voluntary disclosure programs, allowing accountholders to avoid prosecution by coming forward with information regarding their non-compliance.<sup>12</sup> Through December 2012, the first two of these programs brought over 39,000 taxpayers into compliance and generated some \$5.5 billion in back taxes, interest, and penalties for the federal government.<sup>13</sup>

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The current iteration of the IRS's Offshore Voluntary Disclosure Program is being fueled by the Justice Department's Program for Non-Prosecution Agreements or Non-Target Letters for Swiss Banks (Bank Program).<sup>14</sup> This program, which was described in a prior column,<sup>15</sup> has reportedly attracted over 100 "Category 2" banks,<sup>16</sup> each of which is prepared to come forward, describe its purported misconduct, disclose information regarding "U.S. Related Accounts" and affiliated professionals, cooperate with treaty requests, and pay significant penalties.

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Combined with the three IRS programs for accountholders, the Justice Department Bank Program will enable federal authorities to generate revenues, bring numerous taxpayers into compliance, and obtain leads regarding other possible misconduct, all while respecting the sovereignty of the Swiss government. Indeed, by requiring participating banks to make factual disclosures regarding their conduct and to engage Independent Examiners to verify the diligence procedures the banks used to identify their U.S. Related Accounts,<sup>17</sup> the Justice Department Bank Program will generate significant information while using relatively few government resources. And, it is clear that this latest initiative has led individuals who had not previously taken advantage of the IRS's voluntary disclosure programs to remediate their past omissions and declare their accounts. Thus, the Justice Department Bank Program represents yet another way in which the department and IRS are combating illegal conduct and bringing revenue into the federal government even while understaffed.

#### The PSI Report

In stark contrast to the significant efforts of both the IRS and the Justice Department in this arena, just last month, the Permanent Subcommittee on Investigations issued the PSI Report criticizing the IRS and Justice Department for being insufficiently aggressive.<sup>18</sup> Issued under the names of Senators Carl Levin of Michigan, the subcommittee chairman, and John McCain of Arizona, the ranking minority member, the PSI Report draws on an investigation into one Swiss bank, Credit Suisse, and follows up on the Justice Department's 2008 prosecution of another, UBS, which resulted in the revelation of the names of some 4,700 UBS accountholders to the U.S. government.<sup>19</sup> The PSI Report takes issue not only with the fact that after the UBS Deferred Prosecution Agreement, the Justice Department has only prosecuted one smaller Swiss bank, but also with the IRS's voluntary disclosure initiatives and programs for offshore accountholders and banks.

While acknowledging that "significant progress has been made in the effort to combat offshore tax abuses" through, among other things, the IRS voluntary disclosure programs, the PSI Report generally castigates the Justice Department for what the report's authors view as "lax enforcement" of U.S. laws aimed at preventing tax evasion.<sup>20</sup> The evidence of this alleged laxity, however, generally consists of decisions by the Justice Department that reflect limitations on its resources and considerations of international comity.

First, the PSI Report criticizes the Justice Department for its "decision to refrain from taking enforcement action" against Credit Suisse.<sup>21</sup> The report recommends that the department "use available U.S. legal means, including enforcing grand jury subpoenas and John Doe

summonses in U.S. courts, to obtain the names of U.S. taxpayers with undeclared accounts at tax haven banks" and "hold accountable tax haven banks that aided and abetted U.S. tax evasion,"<sup>22</sup> but this recommendation quite evidently elides many of the practical concerns and political realities of U.S.-Swiss relations and cross-border law enforcement.

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Second, the report characterizes both the decision not to prosecute Credit Suisse and the fact that the Justice Department Bank Program does not require that participating banks disclose the identities of accountholders as being "part of a larger failure by the United States to obtain from the Swiss the names of the tens of thousands of U.S. persons who opened undeclared accounts in Switzerland and have not yet paid taxes on their hidden assets."<sup>23</sup> The Bank Program, however, was the product of negotiations with the Swiss Federal Department of Finance and it is doubtful that it would exist if accountholder identification were made a prerequisite to bank participation.

In the meantime, a treaty that "would have given authorities greater access to Swiss banking records," has not yet been ratified due to concerns—raised primarily by Senator Rand Paul of Kentucky—that doing so "will require giving up too much data on U.S. citizens to foreign governments."<sup>24</sup> Moreover, it is difficult to square the Senate's call for increased Justice Department involvement with its failure, until very recently, to agree upon a budget that would return department staffing to the level necessary to implement such a campaign.

#### Conclusion

In today's highly politicized climate, there is always the risk that broader political pressures may be brought to bear on the discretion of prosecutors who seek fair outcomes on a case-by-case basis. Rather than leveling criticisms like those contained in the PSI Report, Congress should acknowledge the impressive results generated by the IRS's voluntary disclosure programs and the participation of numerous Swiss banks in the Justice Department Bank Program, and consider how much more a fully staffed IRS and Justice Department could accomplish.

1. U.S. Department of Justice, "Attorney General Holder Announces Justice Department to Lift Hiring Freeze" (Holder Report) (Feb. 10, 2014) (available at <http://www.justice.gov/opa/pr/2014/February/14-ag-141.html>).

2. Holder Report.

3. U.S. Attorney's Office for the Southern District of New York, "U.S. Attorney's Office for the Southern District of New York Recovers Nearly \$4 Billion From Criminal and Civil Cases Since January 2013" (SDNY Release) (Feb. 11, 2014) (available at <http://www.justice.gov/usao/nys/pressreleases/February14/Collections2013PR.php>).

4. SDNY Report.

5. SDNY Release; see also U.S. Attorney's Office for the Southern District of New York, "NYCLA Task Force on Judicial Budget Cuts—Prepared Testimony of U.S. Attorney Preet Bharara" (Bharara NYCLA Testimony) (Dec. 3, 2013) (available at <http://www.justice.gov/usao/nys/pressspeeches/2013/BhararaNYCLATestimony.php>).

6. See Internal Revenue Service—Criminal Investigation, "Fiscal Year 2013 National Operations Annual Business Report" (IRS Report) (Feb. 24, 2014) (available at <http://www.irs.gov/pub/foia/ig/ci/REPORT-fy2013-ci-annual-report-02-14-2014.pdf>).

7. IRS Report at 2; see also Jeremy H. Temkin, "The Promise of 'Booker' Revisited" (Booker Revisited) NYLJ (Sept. 17, 2013).

8. IRS Report at 3; see also Booker Revisited.

9. See Booker Revisited.

10. U.S. Department of Justice, "Fiscal Year 2012 United States Attorneys' Annual Statistical Report" (FY2012 Report), at 37 (undated) (available at [http://www.justice.gov/usao/reading\\_room/reports/asr2012/12statrpt.pdf](http://www.justice.gov/usao/reading_room/reports/asr2012/12statrpt.pdf)); U.S. Department of Justice, "Fiscal Year 2003 United States Attorneys' Annual Statistical Report" (FY2003 Report), at 85 (undated) (available at [http://www.justice.gov/usao/reading\\_room/reports/asr2003/03\\_STAT\\_Report.pdf](http://www.justice.gov/usao/reading_room/reports/asr2003/03_STAT_Report.pdf)).

11. Jack Townsend, "Offshore Charges/Convictions Spreadsheet" (March 11, 2014) (available at <http://federaltaxcrimes.blogspot.com/p/offshore-charges-convictions.html>).

12. See, e.g., Jeremy H. Temkin, "New Justice Department-Swiss Bank Program Announced" ("DOJ Bank Program Announced"), NYLJ (Oct. 28, 2013); Jeremy H. Temkin, "New Offshore Voluntary Disclosure Program: A Carrot Without a Stick?" NYLJ (July 12, 2012); Jeremy H. Temkin, "Voluntary Disclosure of Offshore Accounts: Yet Another Last Chance," NYLJ (Feb. 17, 2011); Jeremy H. Temkin, "Offshore Banking: The End of the World As We Know It?" NYLJ (Jan. 14, 2010). Because the Voluntary Disclosure programs were only available to taxpayers who were not already under IRS audit or investigation, the revenues generated through these programs required relatively little resource allocation.

13. U.S. Government Accountability Office, "Offshore Tax Evasion: IRS Has Collected Billions of Dollars, but May be Missing Continued Evasion," GAO-13-318 (March 27, 2013) (available at <http://www.gao.gov/assets/660/653369.pdf>).

14. See U.S. Department of Justice, "United States and Switzerland Issue Joint Statement Regarding Tax Evasion Investigations" (Aug. 29, 2013) (available at <http://www.justice.gov/opa/pr/2013/August/13-tax-975.html>).

15. DOJ Bank Program Announced.

16. Robert E. McKenzie, "Swiss Bank Secrecy Succumbs to U.S. Tax Enforcers," Forbes.com (Feb. 3, 2014) (available at <http://www.forbes.com/sites/irswatch/2014/02/03/swiss-bank-secrecy-succumbs-to-u-s-tax-enforcers>).

17. See DOJ Bank Program Announced. The author and his firm have been selected to serve as Independent Examiner for a number of Swiss banks participating in the Justice Department Program.

18. United States Senate—Permanent Subcommittee on Investigations, "Offshore Tax Evasion: The Effort to Collect Unpaid Taxes on Billions in Hidden Offshore Accounts" (PSI Report) (Feb. 26, 2014).

19. PSI Report at 1.

20. PSI Report at 3-4.

21. PSI Report at 5.

22. PSI Report at 7.

23. PSI Report at 5.

24. Joel Schechtman, "Credit Suisse: Senate Forcing Banks to Keep Secrets," WSJ.com (Feb. 27, 2014) (available at <http://blogs.wsj.com/riskandcompliance/2014/02/27/credit-suisse-senate-forcing-swiss-banks-to-keep-secrets/>); see Protocol Amending the Convention between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, U.S.-Switz., Sept. 23, 2009, S. Treaty Doc. No. 112-01 (2011).