

Tax Litigation Issues

Expert Analysis

DOJ Tax Division Today: Interview With Acting Assistant Attorney General

On Aug. 29, 2013, the Department of Justice announced the Program for Non-Prosecution Agreements or Non-Target Letters for Swiss Banks.¹ Between March 30, 2015, and Jan. 27, 2016, the DOJ entered into 78 non-prosecution agreements with a total of 80 Swiss banks, collecting more than \$1.3 billion in penalties, getting a trove of information regarding accounts related to U.S. taxpayers, and ensuring the cooperation of participating banks.

Caroline Ciraolo has served as the Acting Assistant Attorney General of the DOJ's Tax Division since Feb. 25, 2015. In that capacity, she leads the department's civil and criminal tax enforcement efforts. In an interview with Law Journal columnist Jeremy Temkin, Ciraolo discussed the status of the Swiss Bank Program, the Tax Division's commitment to offshore enforcement and its challenges going forward.

Jeremy Temkin: How did the Swiss Bank Program work and what did the Tax Division accomplish through the program?

Caroline Ciraolo: The Swiss Bank Program is an innovative approach to offshore enforcement and represents the best of what can be achieved through ingenuity and collaboration. It has been strongly supported by the department's senior leadership, and has benefited greatly from the assistance of IRS-Criminal Investigation and the IRS Large Business and International Division.

Special agents, revenue agents and analysts have been dedicated to the program for two years, working side-by-side with Tax Division civil trial attorneys, prosecutors and administrative staff to carefully review and analyze the tremendous

By
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volume of information produced. I am extremely proud of those involved in the program and the rest of the Tax Division, which shouldered additional responsibilities during this process.

Under the program, Swiss banks, about which we had little or no information, came forward and admitted to engaging in criminal conduct. These institutions, identified as Category 2 banks,² were required to make a complete

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disclosure of their conduct, provide detailed information regarding U.S.-related accounts, cooperate in treaty requests, provide detailed information about other financial institutions that transferred funds into secret accounts or that accepted funds when secret accounts were closed, and agree to cooperate in related criminal and civil proceedings.

Category 2 banks also were required to pay appropriate penalties, which could be mitigated if the bank established, within the requirements of the program, that a U.S.-related account was not undeclared, was reported by the bank to the IRS, or that the bank had successfully urged the accountholder to enter one of the IRS voluntary disclosure programs. Banks that satisfied

these requirements and agreed to the proposed penalties were eligible for non-prosecution agreements.

The program has also played a critical role in pushing U.S. taxpayers into compliance. Since the first Offshore Voluntary Disclosure Program (OVDP) was announced in 2009, the IRS has received more than 54,000 voluntary disclosures, more than 30,000 streamlined filing submissions, and more than \$8 billion in tax, penalties and interest.³ The number of Reports of Foreign Bank and Financial Accounts (FBARs) filed has increased from nearly 350,000 in 2008, to nearly 900,000 in 2013, to more than 1.1 million in 2015.

The IRS has conducted thousands of offshore-related civil audits, resulting in millions of dollars in assessments, and the department and the IRS have pursued criminal investigations leading to billions of dollars in criminal fines and restitution.

Next Steps

Temkin: How does the department plan to use the information it gathered from the banks participating in the program?

Ciraolo: The conclusion of the Category 2 agreements is a major milestone, but does not represent the conclusion of the program. While the department views the program's accomplishments thus far as a success, our work in the program is ongoing.

The department and the IRS are actively reviewing the information obtained from the Category 2 banks, treaty requests, whistleblowers, and cooperators, and using this information to identify and investigate U.S. accountholders who willfully concealed their foreign accounts and evaded U.S. tax, as well as those entities

and individuals, foreign and domestic, that facilitated this criminal conduct. The information gathered and leads developed are playing a critical role in pending criminal investigations, leading to new targets, advancing civil examinations, and serving as the basis for future enforcement actions.

The Tax Division is deploying all available tools to obtain the information IRS agents need to pursue their investigations. For example, our civil trial attorneys are seeking the enforcement of administrative summonses, including Bank of Nova Scotia summonses and requesting the issuance of John Doe summonses.⁴ Department prosecutors also seek to enforce grand jury subpoenas for foreign account records. Attempts to block such efforts have proven unsuccessful, with eight courts of appeals to date recognizing the required records exception to the Fifth Amendment act of production privilege.⁵

Finally, Tax Division attorneys and IRS personnel are reviewing the information received from Swiss banks that fall under Category 3 and Category 4 of the program. Category 3 and 4 banks maintain that they did not commit any violations of U.S. law, and seek a non-target letter after providing information required by the program.

Temkin: Switzerland was not the only country that offered bank secrecy to U.S. taxpayers. How does the Tax Division intend to deal with banks in other jurisdictions that enabled customers to evade their U.S. tax obligations?

Ciraolo: Offshore tax enforcement remains a top priority for the Tax Division. We are looking well beyond Switzerland, into jurisdictions around the world, including those referenced in the statements of facts admitted to by the Category 2 banks in connection with the tax evasion efforts of U.S. taxpayers. These jurisdictions include, but are not limited to, the British Virgin Islands, the Cayman Islands, the Channel Islands, Guernsey, Hong Kong, Israel, Liechtenstein, Luxembourg, Panama and Singapore.

The Tax Division understands that some foreign financial institutions would like to see a formal program established for entities that engaged in criminal conduct and are located in countries other than Switzerland. The Swiss Bank Program helped pave a path forward for Swiss banks to reach a resolution with the department, and central to the program are the factors considered by the department in determining the proper treatment of a potential criminal target.

Individuals or entities that assisted U.S. accountholders to conceal foreign accounts and evade U.S. tax will not improve their situation by sitting back and delaying disclosure in the hope of an announcement of another program, particularly while we are actively reviewing information received and opening up additional investigations. Timeliness in coming forward and cooperating remains a critical factor in any criminal resolution.

Temkin: How does the department intend to address individuals and entities who were identified by the Category 2 banks as having engaged in culpable conduct?

Ciraolo: We are following the money, and are focused not only on foreign banks, but also on asset management companies, corporate service providers, financial advisors, insurance companies, and other entities that enabled offshore tax evasion. For example, on Oct. 6, 2015, the department signed a non-prosecution agreement with Finacor SA, a Swiss asset management firm, reflecting our willingness to reach appropriate resolutions with individuals and entities that come forward in a timely manner, disclose all relevant information regarding their illegal activities, and cooperate fully and completely, including naming individuals engaged in criminal conduct in accordance with the department's commitment to individual accountability, as reflected in the memorandum issued by Deputy Attorney General [Sally Quillian] Yates on Sept. 9, 2015.⁶ Each individual or entity will be considered on a case-by-case basis, and any resolution will depend on the timing of the disclosure, the nature and extent of the conduct, and the level of cooperation.

Ongoing Efforts

Temkin: In August 2013, there were reportedly 14 Swiss banks that were already under criminal investigation and therefore ineligible to receive non-prosecution agreements under the program (i.e., Category 1 banks). When do you anticipate the department completing its investigation of those banks and what impact will the resolution of those investigations have on taxpayers holding accounts at those banks?

Ciraolo: The department's investigations of Category 1 banks are ongoing. On Feb. 4, 2016, the department entered into a deferred prosecution agreement with Bank Julius Baer, imposing a monetary sanction of \$547 million

and requiring ongoing cooperation.⁷ The department continues to pursue investigations of other foreign financial institutions, and will make announcements regarding these investigations at the appropriate time.

U.S. accountholders who have participated in the IRS offshore voluntary disclosure programs may be contacted and interviewed about the institutions at which they held undeclared accounts and the individuals and entities that assisted them in concealing those accounts. In addition, while the OVDP remains an option, at least for now, taxpayers should bear in mind that the penalty increases from 27.5 to 50 percent of the high value of the accounts under certain circumstances.

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Specifically, the higher penalty applies if, at the time the taxpayer initiates their disclosure, either a foreign financial institution at which the taxpayer had an account or a facilitator who helped the taxpayer establish or maintain an offshore arrangement has been publicly identified as being (a) under investigation, (b) the recipient of a John Doe summons, or (c) cooperating with a government investigation, including having executed a deferred prosecution or non-prosecution agreement.⁸

As of today, the number of institutions that fall within these categories has expanded to 95, and grows with each public announcement. Equally important, taxpayers are barred from the OVDP once the IRS initiates a civil examination or a criminal investigation of their tax compliance.

Temkin: Given the number of taxpayers who have already cured their historical non-compliance through either the OVDPs or Streamlined Procedures, is it realistic to think that offshore accountholders who have not already done voluntary disclosures are going to come forward at this point?

Ciraolo: After seven years of voluntary disclosure programs, nearly 200 criminal prosecutions, and the increased assessment and suits to collect FBAR penalties, a taxpayer's claims of ignorance or lack of willfulness in failing to comply with disclosure and reporting obligations are not well-received. Similarly, we are very interested in taxpayers who filed tax returns and FBARs pursuant to the Streamlined filing procedures, or the Delinquent International Information Return or FBAR submission procedures, who falsely claimed either to have engaged in non-willful conduct or to have acted with reasonable cause.

For those accountholders who have not yet come forward, time is running out. Those who fail to enter the IRS offshore voluntary disclosure programs may face substantial civil penalties or, if warranted, a criminal investigation.

Budget Cuts

Temkin: Over the past several years, the IRS has suffered significant budget cuts to the point that it now has approximately 2,300 special agents, a decrease of over 1,000 agents from its historic high in 1995. The decrease in revenue agents conducting civil examinations and revenue officers pursuing collection activity has been similarly dramatic. At the same time, the IRS has been devoting increasing resources to combating identity theft and implementing the Patient Protection and Affordable Care Act and the Foreign Account Tax Compliance Act.⁹ How have the IRS's budget cuts affected the Tax Division's ability to pursue its mission of "enforc[ing] the nation's tax laws fully, fairly, and consistently, through both criminal and civil litigation, in order to promote voluntary compliance with the tax laws, maintain public confidence in the integrity of the tax system, and promote the sound development of the law"?

Ciraolo: Our civil trial attorneys are responsible for nearly 6,000 cases in various stages of resolution, with 65 percent of their time spent defending cases filed against the United States. Our civil referrals from the IRS have not declined, and our attorneys remain committed to ensuring the full, fair, and consistent enforcement of our tax laws through litigation in the federal courts.

In each civil case, we conduct an independent review of the IRS's positions and administrative determinations to help ensure that the government's position is consistent with applicable law and policy. This independence, backed by

a willingness to engage in aggressive litigation where appropriate, promotes the effective collection of taxes owed. In the past year, the Tax Division's collections in civil litigation and judgments that prevented unwarranted refund claims exceeded \$900 million.

The Tax Division's criminal enforcement sections receive requests from the IRS to prosecute violations after the IRS has completed an administrative investigation. In other cases, the IRS asks the Tax Division to authorize grand jury investigations to determine whether prosecutable tax crimes have occurred, or provides notice of the expansion of existing non-tax grand jury investigations to include tax charges. In recent years, there has been an increase in cases that originate in the Tax Division as a result of leads received from various sources, including the Swiss Bank Program, responses to treaty requests, whistleblowers and cooperators.

In the past two years, the Tax Division has been able to get back to full strength after cuts resulting from the budget sequester. We currently have more than 200 civil trial attorneys, more than 100 prosecutors, and approximately 50 appellate attorneys working hard in support of the Tax Division's mission. We continue to collaborate with our partners within the IRS and the Offices of the U.S. Attorneys to sharpen our focus on our priorities, select the best cases for civil and criminal offshore enforcement, and promote effective and efficient tax administration and voluntary compliance.



1. The program offered Swiss banks that were not already the target of a criminal investigation an opportunity to resolve their potential liability for having assisted taxpayers evade their U.S. tax obligations. For details regarding the Program, see Jeremy Temkin, "New Justice Department-Swiss Bank Program Announced," *New York Law Journal* (Oct. 28, 2013).

2. By contrast, Category 1 banks are those that were already under criminal investigation at the time the program was announced, and Category 3 and 4 banks were those that claimed not to have engaged in any violations of U.S. law.

3. In general, the IRS's voluntary disclosure programs enable taxpayers to effectively eliminate criminal exposure and substantially reduce their civil penalties by coming forward, amending their previously filed income tax returns, filing delinquent FBARs, and paying taxes, interest and penalties, including a "miscellaneous" penalty based on the size of their previously undisclosed accounts. Participants in the original OVDP were required to file six years of amended returns and to pay a miscellaneous penalty equal to 20 percent of their previously undisclosed accounts, while participants in the current program are required to amend eight years of

returns and pay a 27.5 or 50 percent miscellaneous penalty depending on where they maintained their accounts.

Taxpayers whose failure to comply with offshore reporting requirements was non-willful can participate in a Streamlined Offshore or Streamlined Domestic Filing Procedures. Under these procedures, participants amend three years of tax returns and file six years of FBARs and other delinquent reports. While U.S. residents pay the taxes, interest, and a penalty equal to 5 percent of the previously undisclosed assets, non-residents are only required to pay the back taxes and interest.

This column has previously described the various iterations of the Internal Revenue Service's Offshore Voluntary Disclosure Programs and Initiatives, and well as the Streamlined Filing Procedures. See Jeremy Temkin, "One Last Chance for Offshore Account Holders," *New York Law Journal* (May 14, 2009); Jeremy Temkin, "Voluntary Disclosure of Offshore Accounts: Yet Another 'Last' Chance," *New York Law Journal* (Feb. 17, 2011); Jeremy H. Temkin, "New Offshore Voluntary Disclosure Program: A Carrot Without a Stick?," *New York Law Journal* (July 12, 2012); Jeremy Temkin, "Offshore Accounts: The Beat Goes On," *New York Law Journal* (July 16, 2015).

4. A Bank of Nova Scotia summons seeks to compel the U.S. branch of an overseas bank to produce records from a branch located in a jurisdiction that offers bank secrecy. See *Bank of Nova Scotia v. United States*, 487 U.S. 250 (1988). A John Doe summons seeks information regarding a specific, unidentified person or group or class of persons, and can only be issued with the approval of a federal district court judge. See 26 U.S.C. §7609(f).

5. See, e.g., *In re Grand Jury Subpoena Dated February 2, 2012*, 741 F.3d 339 (2d Cir. 2013).

6. For a discussion of the Yates Memorandum, see Robert Anello and Richard Albert, "Latest Approach on Prosecuting Individuals for Corporate Misconduct," *New York Law Journal* (Oct. 6, 2015).

7. In *United States v. Bank Julius Baer & Co.*, S3 11 Cr. 866 (LTS), Julius Baer was charged in a Criminal Information filed in the Southern District of New York with having conspired to help U.S. taxpayers hide billions of dollars in offshore accounts from the IRS and to evade U.S. taxes on the income earned in those accounts.

8. The list of banks and facilitators whose customers are subject to the 50 percent penalty is available at <https://www.irs.gov/Businesses/International-Businesses/Foreign-Financial-Institutions-or-Facilitators>.

9. Patient Protection and Affordable Care Act, 42 U.S.C. §18001 et seq. (2010); FATCA, 26 U.S.C. §1471 et seq.