Bank secrecy and data collection in the U.S. tax enforcement context

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Introduction

In recent months, and in particular further to the filing and submission in the Southern District of Florida of a "John Doe" summons against UBS AG, the question of the "value" of bank secrecy, in particular in relation to the U.S., has come to the forefront of the international banking arena. Like many countries around the world, the U.S. is increasingly trying to use alternative methods to obtain information regarding their taxpayers, methods which go above and beyond the exchange of information provisions set forth in many international treaties. As a result, a far more aggressive attitude with respect to the wealth management sector is developing.

This article briefly outlines the U.S. approach to data collection in the tax enforcement context which can cause serious conflicts with Swiss bank secrecy. Swiss banks may only release confidential client data to foreign authorities in accordance with international treaties. Failure to comply with this rule constitutes a criminal offense under Swiss law (Art. 47 Swiss Banking Act).

International tax treaties

Numerous tax treaties provide for the mutual exchange of information. The tax treaty between the U.S. and Switzerland and the related U.S.-Swiss Exchange of Information Agreement dated January 23, 2003 ("Exchange of Information Agreement"), for instance, provide for the exchange of information in the case of tax fraud and related offenses ("tax fraud and the like")[1].

Swiss legal authors have even argued that in the Exchange of Information Agreement with the U.S., the definition of cases to be considered "like tax fraud" at least partly goes beyond the relevant provision of tax fraud for which Switzerland is generally prepared to grant assistance to foreign authorities in tax matters.

Nevertheless, the U.S. has been reluctant to invoke procedures under treaties largely due to their perceived inefficiency resulting from numerous built-in "safeguard" provisions. When describing a request for information from the U.S. government to Switzerland, the deputy commissioner of the IRS stressed the hindrances created by the built-in safeguards:

"Even if such a request is made pursuant to the Swiss treaty, the account holders whose information is the subject of the request would be notified by the Swiss government and granted the right to object to the production of their records. If the account holder objects to the production of the records, a Swiss court would determine if the records could be produced under the treaty. The Swiss court would approve the production of records only if it found evidence of tax fraud"[2].

The QI system and other alternatives

The QI regime has unilaterally been designed by the U.S. to stop abuses in the U.S. withholding tax system. Indeed, many non-U.S. taxpayers were reducing their U.S. withholding rates via banks or other intermediaries in countries with favorable tax treaties, although they were not entitled to such reductions. The QI system generally requires any individual investing in U.S. securities to disclose full beneficial ownership of such securities except if the investment is made through a banker or other intermediary located in a country that has adequate exchange-of-information provisions with the U.S. and adequate "know-your-client" rules.

Such an intermediary may, with the IRS's approval, become a QI by entering into a QI agreement with the IRS. Under this agreement, the QI agrees to establish and implement procedures to properly identify all of its customers and to be audited periodically at its own expense to ensure that it has implemented its procedures to identify its customers (i.e., that it keeps adequate records and provides information to the IRS with respect to such investors)[3].

We further note that technological advances are creating greater enforcement opportunities which the U.S. (as well as other countries) are using increasingly. The U.S. has used information from credit cards – particularly Visa, MasterCard and American Express – to gather data from local computer systems. The same strategy was used with the online payment website PayPal to obtain similar types of information. Another example is the Joint International Tax Shelter Information Center, where major taxing jurisdictions regularly share their concerns and enforcement solutions[4].

The U.S. has also used other alternative methods to obtain data regarding its taxpayers (in an attempt not to go through the procedures under the relevant treaties), including the following:

- Enforcement of summonses and subpoenas against non-U.S. persons or entities on the basis of presence in the U.S. or submission of such persons or entities to U.S. jurisdiction; for instance, in the case of a Swiss bank with a branch in the U.S., this is a strong argument for jurisdiction;

- Consent decrees: Courts have compelled non-U.S. institutions to avail themselves of jurisdiction and hand over data in certain circumstances;

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- Material witness warrants: Arrest in the case of a person whose testimony is deemed to be material to a criminal proceeding, if it is shown that it may become impracticable to secure the presence of the person by subpoena (such as in the case of a UBS employee in the Birkenfeld matter);

- Monetary rewards for reporting a non-compliant individual to the IRS ("whistleblowing").

Consequences and conclusions

The measures described above do not allow a Swiss bank or a Swiss banker to release client-related data without the consent of the clients concerned. However, those measures (and the U.S. sanctions imposed or threatened with them) often put high pressure on the relevant institutions or persons and, thus, create a very uncomfortable situation of constraint, the more so where those actions are associated with high publicity. They either comply with U.S. law and thereby violate bank secrecy or they adhere to their confidentiality obligations with the result of potentially facing severe sanctions or very bad publicity in the U.S.

If in such a situation a Swiss banker violates bank secrecy, he might in very serious cases successfully plead necessity (Notstand) under Swiss criminal law and, hence, avoid punishment[5].

While the U.S. has, in principle, been constructing a wide net of tax exchange-of-information agreements, this is only one of the methods used by the U.S. to obtain information. To the extent the U.S. can obtain information unilaterally, it will continue to do so and avoid resorting to the potentially lengthy procedures of international assistance pursuant to tax or other treaties.

However, Switzerland should nevertheless continue to stress the importance of international treaties and keep referring the U.S. (and other foreign countries) back to the procedures laid down in the international treaties. Unilateral measures are often nothing else than an interference with Swiss sovereignty[6]. Notwithstanding, the risk of a Swiss bank to find itself between a U.S. disclosure obligation and Swiss bank secrecy is obviously increased where a Swiss bank has a branch in the U.S. or a license or other significant business interest in the U.S.

1) See Daniel Hufschmid: "Tax fraud and the like", in: ASA 72/2004, p. 433 et seq.; see also Affentranger / Marcovici: "Auskunftspflichten und Rechtshilfe in Steuerangelegenheiten", in: Angriffe auf das Bankgeheimnis (Seminarpublikation Baker & McKenzie Zurich), Zurich 2008, p. 43 et seq.

2) See affidavit of Barry Schott, paragraph 11, in the matter of the tax liabilities of John Does; No. 08-21864.

3) See Michaels / Balaban / Connors / Marcovici / O'Donnell, "Nine Months of Working with the QI Agreement: What Has the IRS Wrought?", 11 JOIT 4 (November 2000).

4) www.irs.gov/pub/irs-utl/jitsic-finalmou.pdf.

5) See Stratenwerth, in: Basler Kommentar Bankengesetz, Basel / Genf / München 2005, N 43 et seq. to Art. 47 Swiss Banking Act.

6) See Stratenwerth, supra, N 44 to Art. 47 Swiss Banking Act.

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