The U.B.S. Case: the U.S. Attack on Swiss Banking Sovereignty

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I. INTRODUCTION

II. THE IRS OFFSHORE ATTACK

a. The Case of the Billionaire Brothers

b. The Voluntary Disclose Initiative

c. Other IRS Offshore Enforcement Issues

d. Non-Filers with Foreign Bank Accounts

III. THE U.S.-SWISS TAX INFORMATION EXCHANGE AGREEMENT

a. The 2003 Changes

b. Policy Behind Updating the TIEA

IV. THE UBS CASE

a. Why UBS?

b. The Case

c. Outcome

V. ANALYSIS

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a. Likely Changes to the U.S.-Swiss TIEA

b. Future of Swiss Banking Privacy vis-a-vis the U.S.

c. Is this Good Policy?
   i. Meddling in Other Country’s Sovereignty
   ii. True Purpose of the UBS Case and Effect

VI. CONCLUSION

I. INTRODUCTION

On August 1, 2006, the United States Senate’s Permanent Subcommittee on Investigations (“PSI”), a branch of the Committee on Homeland Security and Governmental Affairs, released a report in conjunction with a Senate hearing that revealed alarming statistics regarding wealthy Americans’ love affair with offshore banking.\(^1\) The PSI report was a culmination of the subcommittee’s investigation into tax haven abuses, providing the most detailed look to date of high-level tax schemes.\(^2\) The report revealed such an alarming number of rich Americans are using offshore accounts to evade taxes that law enforcement is unable to control the growing misconduct.\(^3\) Senator Carl Levin (D-Mich.), Chairman of the PSI, stated, “The universe of


\(^3\) Id.
offshore tax cheating has become so large that no one, not even the United States government, could go after it all.”

This statement marks the first salvo in the new United States attack on offshore tax evasion. The principal focus of this attack appears to be in unreported offshore bank accounts. The most conspicuous historical jurisdiction for U.S. residents with such accounts is Switzerland due to its stringent banking laws and stronghold on foreign money. While there is an existing tax information exchange agreement (“TIEA”) between the U.S. and Switzerland (last significantly revised in 2003), the newly minted U.S. attack focuses on Swiss accounts and the U.S. attempt to obtain account holder information from UBS AG has allowed this fight to evolve into a judicial battle.

The policy goals of the U.S. here are clearly valid, but the means of obtaining the information is overbroad given how vigorously the U.S. guards its own legal exceptionalism. Understandably, the Swiss have a valid concern that the U.S. is not respecting Swiss domestic laws.

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4 See Tax Cheats Called Out of Control, supra.


6 Martin Crutsinger, U.S., Switzerland Agree to Crack Down on Tax Evaders, USA TODAY, June 20, 2009, available at http://www.usatoday.com/money/perfi/taxes/2009-06-19-us-switzerland-tax-treaty_N.htm (stating: Swiss banks hold an estimated $2 trillion dollars in foreign money. Additionally, financial services add about 12% to the country’s economic output. According to the Boston Consulting Group, these holdings total one-forth of the world’s foreign owned assets).

7 Staff of the Joint Committee on Taxation, Tax Compliance and Enforcement Issues with Respect to Offshore Accounts and Entities, Mar. 30, 2009, (JCX-23-09) at 31-33 (scheduled for a Public Hearing before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means on Mar. 31, 2009).
law. The U.S., after all, has personal jurisdiction over its own citizens – surely there are better ways of obtaining this information while respecting the domestic laws of another sovereign country, especially an ally such as Switzerland.

The focus of this paper is to dissect the intricacies and arguments surrounding the U.S. attack on offshore banking in an attempt to curtail, arguably, rampant tax evasion, followed by a detailed look into the development, policy implications, and consequences of the *U.S. v. UBS AG* case.

II. IRS OFFSHORE ATTACK

Sen. Carl Levin, as the Chairman of the PSI, is the U.S. Senator who is leading the investigations into offshore tax evasion. Not only do the offshore schemes being targeted by Sen. Levin and the PSI drastically reduce the U.S. government’s ability to monitor its citizens’ financial situations, but they also, significantly add to the tax gap (the difference between taxes owed and taxes paid). The U.S. government has a strong interest in uncovering these schemes. Especially in this time of economic turmoil, the government is concerned about the billions lost in tax revenue. According to Sen. Levin, such schemes are “undermining the integrity of the [American] tax system and renders the government unable to pay for critical needs, avoid going


9 See id.
deeper into debt, and protect honest taxpayers” and, therefore, must be shut down.\textsuperscript{10} Specifically, these tax schemes rob the U.S. Treasury of more than $100 billion each year, shifting the tax burden from high-income individuals and companies onto the backs of middle and working class families.\textsuperscript{11} Additionally, strict offshore secrecy rules, such as those implemented by Switzerland, make it possible for taxpayers to participate in illicit activity with little fear of getting caught.\textsuperscript{12} These laws permit offshore service providers to carry on procedures that allow them to go to “extraordinary” lengths to protect U.S. clients’ identities and financial information.\textsuperscript{13} These “perks” hinder U.S. tax and regulatory authorities in such a way that it is difficult, if not impossible, for U.S. law enforcement to get information necessary to enforce U.S. tax laws.\textsuperscript{14}

On April 20, 2009, at the G-20 Summit in London, the U.S., the United Kingdom, France and Germany sought to pressure financial centers worldwide to modify their banking secrecy


\textsuperscript{11} See \textit{id.} at 36.

\textsuperscript{12} Id.

\textsuperscript{13} Id. at 37.

\textsuperscript{14} Id.
laws. While each country has their own reasons for exerting such pressure, this part of the paper will focus on the U.S. reasons for doing so, including the billionaire brothers whose scheme gave credence to the concerns outlined in the 2006 PSI investigation\textsuperscript{16}, the government’s attempt to reign in tax evaders through the Voluntary Disclosure Initiative\textsuperscript{17}, other offshore enforcement issues\textsuperscript{18}, and non-filers with foreign bank accounts.\textsuperscript{19}

\subsection*{a. The Case of the Billionaire Brothers}

In September 2006, Forbes ranked Samuel Wyly as the 354\textsuperscript{th} richest American.\textsuperscript{20} Forbes estimated Sam’s net worth to be around $1.1 billion, earned mostly from investments.\textsuperscript{21} While

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\begin{itemize}
\item[\textsuperscript{16}] See \textit{Tax Haven Abuses: The Enablers, The Tools, and Secrecy}, supra at 113-360.
\item[\textsuperscript{18}] See Testimony before the Committee on Finance, U.S. Senate: Tax Compliance – Offshore Financial Activity Creates Enforcement Issues for the IRS, supra at 7-11.
not wealthy enough to make the Forbes list, Sam’s older brother Charles’s personal portfolio was still almost equal to Sam’s abundant wealth. The Wyly brothers, Texan entrepreneurs, are not only notorious for their eye-popping wealth, but also for the multiple tax evasion investigations into them pursued by separate federal and states agencies.

In 2005, Michael’s Stores Inc. released a statement conceding that the U.S. Securities and Exchange Commission and the New York County District Attorney were investigating the stock transactions of the Wyly brothers, the company’s President and Vice-President. However, this charge was small potatoes compared to the investigation revealed in the previously mentioned 2006 PSI report. According to the investigation, early in the 1990s the brothers set about

21 Id.


24 See Another Bad Batch of Bush Money, supra.

establishing fifty-eight offshore trusts and corporations, which they operated for more than thirteen years without alerting the U.S. authorities.\textsuperscript{26} The brothers located the trusts, set up in the name of individual family members, in the Isle of Man – a noted tax haven.\textsuperscript{27} To move funds abroad, the brothers transferred over $190 million in stock option compensation they had received from U.S. publicly traded companies, Michael’s being one of many, to the offshore corporations.\textsuperscript{28} When confronted about the staggering amount of untaxed money, the billionaire brothers claimed that they did not have to pay tax on this compensation because, in exchange for it, the offshore corporations provided private annuities that would not initiate payments to them until years later.\textsuperscript{29} In the interim, the brothers proceeded to direct offshore corporations to cash in stock options and start investing the money.\textsuperscript{30} These offshore stock transactions were not disclosed to the U.S. SEC despite the brothers’ positions as directors and major shareholders in the relevant companies.\textsuperscript{31}


\textsuperscript{27} See Another Bad Batch of Bush Money, \textit{supra}.


\textsuperscript{29} \textit{Id.} at 2-3.

\textsuperscript{30} \textit{Id.} at 3.

\textsuperscript{31} \textit{Id.}
The PSI was able to trace more than $600 million in untaxed stock option proceeds that Sam and Charles Wyly invested in the various ventures they controlled, including two hedge funds, an energy company, and an offshore insurance firm.\(^{32}\) To add insult to injury, the brothers also used the offshore trusts to allocate $115 million in untaxed dollars to purchase real estate, jewelry, and artwork for themselves and family members.\(^{33}\) These personal purchases were made under the pretense that the brothers could use offshore dollars to advance their personal and business interests without having to pay any taxes on the offshore income.\(^{34}\) The Wyly brothers were able to carry on these evasive and manipulative tax maneuvers largely because all their activity was shielded by the offshore country’s domestic secrecy laws and practices.\(^{35}\)

Despite their funds being offshore, the Wylys directly controlled all the accounts and assets.\(^{36}\) The brothers and their representatives communicated their directives to a “trust protector” who then relayed these directions to the offshore trustees.\(^{37}\) The PSI investigations

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\(^{32}\) Id.; See Tax Haven Abuses: The Enablers, The Tools, and Secrecy, supra at 118.


\(^{34}\) See Statement of Sen. Carl Levin Introducing the Stop Tax Haven Abuse Act, Part I, supra at 3.

\(^{35}\) Id.


\(^{37}\) See id.
revealed that these trustees never once rejected a Wyly order and never initiated an action without direct Wyly approval.\textsuperscript{38} Sen. Levin explained how simple it was for these billionaire brothers to take advantage of a practice dubbed the “Foreign Trust Loophole.”\textsuperscript{39} The Wylys’ offshore trustees had “discretion” to name beneficiaries of the offshore trusts, which were, for paperwork purposes, companies located in the offshore country.\textsuperscript{40} However, the application of this discretion already had been determined, since the trustees had been informed that the trusts’ assets were to go to the Wyly children upon the death of their respective father.\textsuperscript{41} The trustees also knew they could be replaced if they failed to comply with the Wylys’ instructions.\textsuperscript{42} Additionally, in accordance with the trust protector’s orders, the trustees authorized millions of

\begin{quote}
\textsuperscript{38} See id.
\end{quote}

\begin{quote}
\textsuperscript{39} Id. at 8-9; Will Deener, Tax Probe Widens – Investigations into Trusts Involving Wylys May Include 42 Firms, THE DALLAS MORNING NEWS, June 4, 2005, available at http://www.dallasnews.com/ (describing the Wylys’ tax evasion scheme as:

“First a public company grants stock options to a senior executive. The executive then transfers the options to a trust or partnership controlled by the executive’s family. The parties then structure the transfer as a ‘sale’ and the trust then ‘pays’ the executive for the options with a long-term or deferred note…Shortly after then options are transferred, the trust exercises the stock options and sells the stock in an open market. The executive then takes the position that tax is not owed until the date of the deferred payment…although the executive has access to the partnership assets.”).
\end{quote}

\begin{quote}
\textsuperscript{40} See Statement of Sen. Carl Levin Introducing the Stop Tax Haven Abuse Act, Part I, supra at 8.
\end{quote}

\begin{quote}
\textsuperscript{41} See id.
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\begin{quote}
\textsuperscript{42} See id.
\end{quote}
dollars in trust income to be invested in Wyly businesses and used to purchase personal property for the Wyly family.43

When called by the PSI in 2006, Sam and Charles Wyly stated they each would invoke their Fifth Amendment right against self-incrimination and, thus, were not actually asked to testify.44 A statement released by the billionaire brothers’ attorney, William Brewer, insists that Sam and Charles are innocent, stating, “The Wylys believe they have paid all taxes due.”45

b. The Voluntary Disclose Initiative

On March 23, 2009, the Internal Revenue Service, in response to the growing resistance to continued tax evasion, announced a new initiative the agency hoped would encourage tax evaders to come back into the fray of legal activity.46 This Voluntary Disclosure Initiative

43 See id at 8-9.

44 See Tax Cheats Called Out of Control, supra at 1.

45 Id. (also stating:

“And in, any event, as the [PSI] report makes clear, the Wylys were counseled by an armada of lawyers, brokers, financial professionals, and offshore service providers to ensure that they were at all times fully meeting their obligations.”).

significantly lowered the penalties for unpaid taxes for those individuals or companies that voluntarily disclosed their offshore accounts under the program.\textsuperscript{47} The program took effect on March 23, 2009 and initially terminated on September 23, 2009.\textsuperscript{48} The program was available for all taxpayers with legal source income who made timely, accurate, and complete disclosures to the IRS, satisfying the requirements of the Internal Revenue Manuel, and pay (or make arrangements to pay) the taxes due.\textsuperscript{49}

\textsuperscript{47} See id.

\textsuperscript{48} Id.

\textsuperscript{49} IRS Issues Voluntary Disclosure Guidance for Unreported Offshore Accounts and Entities, supra at 2; Internal Revenue Manuel § 9.5.11.9 (West 2009) (stating:

“(3) A voluntary disclosure occurs when the communication is truthful, timely, complete, and when: (a) the taxpayer shows a willingness to cooperate with the IRS in determining his/her tax liability; and (b) the taxpayer makes good faith arrangements with the IRS to pay in full, the tax, the interest, and any penalties determined by the IRS to be applicable.

(4) A disclosure is timely if it received before: (a) the IRS has initiated a civil or criminal examination/investigation, or has notified taxpayer it intends to commence such; (b) IRS has received information from a 3rd party alerting the IRS to a taxpayer’s noncompliance; (c) IRS has initiated a civil or criminal examination which is directly related to the specific liability of the taxpayer; or (d) the IRS has acquired information directly related to the specific liability of the taxpayer from a criminal enforcement action.”).
The IRS’s intent was two-fold. First, the IRS hoped to incentivize noncompliant, eligible taxpayers, to become compliant by setting forth a circumscribed and favorable penalty framework. Second, the government hopes to recoup the lost tax revenue. The policy goals behind the initiative include the desire to provide predictable and effective policy to deal with the potentially (and probably) large class of noncompliant U.S. taxpayers that used offshore accounts without proper disclosure or tax payments, the eventual elimination or reduction in the current difficulty of obtaining information from offshore banking countries, and to satisfy the requests for certainty from practicing tax attorneys and accountants.

In order to satisfy the agency’s intentions and goals, IRS personnel may now apply a new penalty framework to voluntary disclosure requests regarding previously unreported offshore entities and accounts. Under the Voluntary Disclosure Initiative, the IRS will assess taxes and interest for the prior six-year period. Taxpayers will be required to file or amend all returns for

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50 See IRS Issues Voluntary Disclosure Guidance for Unreported Offshore Accounts and Entities, supra.

51 Id.

52 Id.

53 See id.

54 Id.

55 Id. (Providing an exception where an account or entity was formed or acquired within the six-year “look back” period. In these cases, the taxes and interest will be assessed starting with the earliest year in which the account was created or acquired, or the entity was formed.).
the applicable period, including filing the IRS form called Reports on Foreign Bank and Financial Accounts ("FBAR"). The IRS will assess either an accuracy related penalty or a delinquency penalty on taxes required to have been reported in years within the applicable section, but not those shielded by the reasonable cause exception. In lieu of all other penalties that may apply, including FBAR and information return penalties, the IRS will assess a penalty of twenty percent of the amount in foreign bank accounts or entities in the year with the highest aggregate account or asset value. The penalty can be reduced to five percent in the case of certain inherited accounts.

While the program does not guarantee immunity from prosecution, it is the most effective way to avoid criminal penalties. For cases involving unreported offshore income in which the taxpayer did not come in through the voluntary disclosure program, the IRS is “instructing [the]

56 Id.

57 See id. (explaining that an accuracy penalty is twenty percent of the understatement of the tax and a delinquency penalty is up to twenty-five percent of the net tax required to be shown on the tax return).

58 Id.

59 Id. (providing the requisite conditions are satisfied before qualifying for a reduction, including (1) the taxpayer did not open or cause any accounts to be opened or entities formed; (2) there has been no activity in any account or entity; and (3) all applicable U.S. taxes have been paid on the funds deposited in the accounts or transferred to the entities (except for taxes on income or earnings of the account of entity)).

60 See id.; I.R.M § 9.5.11.9(2) (this does not apply to a taxpayer with illegal income source).
agents to fully develop the case pursuing both civil and criminal penalties, including the maximum penalty for the willful failure to file a FBAR report and the fraud penalty.”

In conjunction with this program, the IRS posted a form to its Website that taxpayers had access to for use in providing the necessary information to be considered for the Voluntary Disclosure Program. According to Bruce Friedland, IRS spokesman, this form was designed to streamline the process and cut down on the back-and-forth among taxpayers, their advisers, and the IRS on what information is needed. The emphasis appears to have paid off as the IRS is pleased with the initiative’s response. Declining to give exact numbers, Friedland stated that during the week of July 20, 2009 alone, the IRS received more than four hundred requests to

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61 Statement, Douglas Shulman, Commissioner, Internal Revenue Service, Conference Call re Voluntary Disclosure Initiative, Mar. 26, 2009 (stating, “Those who truly come in voluntarily will pay back taxes, interest, and a significant penalty, but can avoid jail time.”).

62 IRS Streamlines Offshore Disclosure Process, supra; Memorandum from the IRS, Offshore Voluntary Disclosures – Optional Format (July 29, 2009) (on file with agency) (the three-page form asks the taxpayer to (1) provide an explanation of the source of the offshore funds; (2) disclose whether he/she is currently under audit or criminal investigation by the IRS; (3) estimate the highest aggregate foreign account value and the total reported income for 2003-2008; and (4) list where the account or asset was located and when the account was opened or closed; (5) explain the purpose for establishing the account or asset; (6) list each person or entity affiliated with the account and explain the nature of its relationship to the account; and (7) explain all communications with the financial institution regarding the account or asset).

63 Id.

64 See id.
participate in the program.\textsuperscript{65} This number represents more than four times the total number of requests received for the entirety of 2008.\textsuperscript{66}

c. \textit{Other IRS Offshore Enforcement Issues}

Despite the Voluntary Disclosure Initiative and several other IRS initiatives targeting offshore tax schemes, tax evasion and fraudulent crimes involving offshore entities remain difficult to detect and prosecute.\textsuperscript{67} Abusive and evasive offshore tax schemes present challenges related to oversight enforcement, the complexity of offshore financial transactions and relationships among entities, the lack of jurisdictional authority to pursue information, the specificity of information necessitated by information-sharing agreements, and issues with third party financial institution reporting.\textsuperscript{68}

A major issue for agency enforcement policy is the time constraint the IRS faces when conducting examinations that include offshore tax issues.\textsuperscript{69} By and large, offshore examinations

\textsuperscript{65} Id.

\textsuperscript{66} Id.

\textsuperscript{67} Testimony before the Committee on Finance, U.S. Senate: Tax Compliance – Offshore Financial Activity Creates Enforcement Issues for the IRS, supra at 7.

\textsuperscript{68} Id.

\textsuperscript{69} Id at 9.
take much longer than their domestic counterparts.\textsuperscript{70} A 2009 U.S. Government Accountability Office report shows that offshore examinations can take, on average, five hundred more calendar days to develop and examine than domestic audits.\textsuperscript{71} The reasons behind this lag include, but are not limited to, technical complexity, and difficulty getting access to information from foreign sources.\textsuperscript{72} Despite the extra issues, offshore examinations have the same statute of limitations as domestic examinations, which prevents the IRS from assessing taxes or penalties more than three years after a return is filed.\textsuperscript{73} This leads to the IRS prematurely ending an offshore examination or choosing not to open one at all – despite evidence of likely noncompliance.\textsuperscript{74} IRS Commissioner Shulman testified that it would be helpful for Congress to extend the time to assess an offshore tax liability to six years.\textsuperscript{75} Congress has yet to codify this request.\textsuperscript{76}

\textsuperscript{70} See id.

\textsuperscript{71} Id.

\textsuperscript{72} Id.

\textsuperscript{73} Id.

\textsuperscript{74} Id.

\textsuperscript{75} Id.

\textsuperscript{76} See id.
Another problem for the IRS is the Qualified Intermediary ("QI") program.\textsuperscript{77} While an effective program, it is insufficient to address all instances of offshore tax evasion.\textsuperscript{78} Under the QI program, foreign financial institutions voluntarily report to the IRS income and earned taxes withheld on U.S. source income, providing some assurance that taxes for U.S. source income sent offshore are properly withheld and income is properly reported.\textsuperscript{79} Unfortunately, significant gaps exist in information available to the IRS about offshore account owners.\textsuperscript{80} Additionally, a

\textsuperscript{77} See id.; Tax Compliance and Enforcement Issues with Respect to Offshore Accounts and Entities, supra at 22-25 (stating:

“A QI is defined as a foreign financial institution or a foreign clearing organization, other than a U.S. branch or U.S. office of such institution or organization, which has entered into a withholding and reporting agreement (‘QI agreement’) with the IRS. In exchange for entering into a QI agreement, the QI is able to shield the identities of its customers from the IRS and other intermediaries in certain circumstances and is subject to reduced information reporting duties compared to those that would be imposed in the absence of the agreement. This ability to shield customer information is limited, however, with respect to U.S. persons, because the QI is required to furnish Forms 1099 to its U.S. customers if it has assumed primary withholdings responsibility for these accounts, or to provide Forms W-9 to the withholding agent in cases in which the QI has not assumed such responsibility.”).

\textsuperscript{78} Testimony before the Committee on Finance, U.S. Senate: Tax Compliance – Offshore Financial Activity Creates Enforcement Issues for the IRS, supra at a.

\textsuperscript{79} Id at 10.

\textsuperscript{80} See id.
low percentage of U.S. source income sent offshore flows through the QIs. In 2003, for example, only about twelve percent of $293 billion in U.S. income flowed through QIs. The rest (about $256 billion) flowed through U.S. withholding agents, who, unlike QIs that are required to verify account owners’ identities, are permitted to accept account owners’ self-certification of their identities at face value. The reliance on self-certification leads to a greater potential for improper withholding because of misinformation or fraud.

Due to the extensive number of problems facing the IRS in offshore tax enforcement, Commissioner Shulman has conceded the tax administration community has come to the general agreement that there is no “silver bullet” or one strategy that can single-handedly solve the problems of offshore tax avoidance. However, despite this grim reality, the IRS has pursued a number of avenues in order to get a handle on the situation. Both the Senate and the House of

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81 *Id.*

82 *Id.*

83 *Id.*

84 *Id.* (stating the UBS cases – discussed later in this paper – demonstrate how QIs are insufficient in eliminating offshore tax evasion).

85 *Id.* at 11.

86 See *id.*
Representatives have introduced identical bills titled the *Stop Tax Havens Abuse Act*. These acts are in the committee stage of both Congressional Houses, which is the first step in the legislative process. On its end, the IRS has both increased the number of international audits since November 2008 and prioritized the stepped-up hiring of international experts and investigators. The IRS is also looking for ways to improve information reporting and sharing.

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87 See generally Senator Carl Levin, Chairman, Permanent Subcommittee on Investigations, Summary of the Stop Tax Haven Abuse Act (Mar. 2, 2009), available at http://levin.senate.gov/newsroom/release.cfm?id=308949. (Senate Bill 506 and House Bill 1265, proposing to (1) allow the Department of Treasury to impose the same penalties used when an institution, foreign jurisdiction, or individual is found to be laundering money to any transaction or entity that the Treasury finds to be impeding on U.S. tax enforcement; (2) authorizing the Secretary of the Treasury to add or remove countries from the list of offshore secrecy jurisdictions, which are viewed as having secrecy laws or practices that unreasonably restrict U.S. tax authorities from obtaining necessary information; (3) cause certain non-U.S. corporations, which are managed and controlled within the U.S., to be treated as domestic corporations and liable for U.S. corporate income tax; and (4) apply withholding tax to payments with respect to stock of U.S. corporations to non-U.S. persons of dividend equivalent amounts and substituted dividends, which are, arguably, not subject to the 30% withholding tax on dividends paid to non-U.S. investors).


89 Doug Shulman, Commissioner, IRS, Testimony before the Senate Finance Committee on Tax Issues Related to Ponzi Schemes and an Update on Offshore Evasion Legislation, (Mar. 17, 2009), available at Senate Finance Committee Website.

90 See id.
Because of the important line of insight into the activities of U.S. taxpayers at foreign banks and financial institutions, the IRS is looking closely at how to continue to improve the QI program.91

d. Non-Filers with Foreign Bank Accounts

Every United States person who has one or more foreign bank account(s) which at any point during the year reach an aggregate balance of over ten thousand dollars is obligated to file a report with the United States Department of Treasury listing all foreign accounts, Form TD F 90-22.1.92 Under this regulation, a “United States person” is any of the following: (1) citizen or resident of the U.S.; (2) a domestic partnership; (3) a domestic corporation; or (4) a domestic estate or trust.93 “Financial accounts” include bank accounts, security/brokerage accounts,  

91 Id. (stating these enhancements include expanding information reporting requirements to include sources of income for U.S. persons with accounts at QI banks, strengthening documentation rules to ensure that the program is delivering on its original intent, and requiring withholding accounts with documentation that is considered insufficient).


93 Id.; William & Thomas Sykes, Recent Developments Encourage Voluntary Correction to Foreign Financial Bank Account Reporting Violations, McDERMOTT NEWSLETTER (McDermott Will & Emery LLP, Int’l.), Apr. 14, 2009, available at http://www.mwe.com/index.cfm/fuseaction/publications.nldetail/object_id/6eb0672c-de23-4242-9312-888af6760b4b.cfm (Stating that a U.S. person has financial interest in each account for which each person is the owner of record or has legal title, regardless of whether the account is maintained for the persons’ own benefit or for the benefit of others, including non U.S. persons. Instructions on Form TD F 90-22.1 now provide that the owner of record or holder of legal title includes a corporation in which the U.S. person directly or indirectly owns more than fifty percent of the total value or more than fifty percent of the voting power of all shares of stock, and a partnership
mutual funds, securities, derivatives, or financial instrument accounts, debit and prepaid credit
cards maintained with a financial institution, and certain types of annuities or pension accounts.\textsuperscript{95} U.S. investors in offshore hedge funds and private equity funds are also required to file a FBAR.\textsuperscript{96}

The failure to file a FBAR or disclose foreign accounts can lead to significant civil and
criminal penalties.\textsuperscript{97} On the civil side, an U.S. person can be fined ten thousand dollars for non-
willful noncompliance and one hundred thousand dollars or fifty percent of the amount of the
in which the U.S. person owns an interest in more than fifty percent of the profits or more than fifty percent of the
capital of the partnership.).

\textsuperscript{94} \textit{Id.} (stating this includes savings, demand, checking, deposit, or any other account maintained with a financial
institution); \textit{See Recent Developments Encourage Voluntary Correction to Foreign Financial Bank Account
Reporting Violations} (Stating that individual bonds, notes or stock certificates and unsecured loans to foreign trade
or business that is not a financial institution is not a financial account. Correspondent or “nosto” accounts –
international interbank transfer accounts – maintained by banks that are used solely for the purpose of bank-to-bank
settlement is also not a financial account.).

\textsuperscript{95} \textit{Id.}

\textsuperscript{96} Kristen A. Parillo, \textit{Hedge Fund, Private Equity Investors Must File FBAR, IRS Confirms}, Tax Analysts, June 29,
2009 (Doc. 2009-14609) (stating there has been confusion over the rules in recent years).

\textsuperscript{97} Dan Meehan & Bill Morrow, \textit{Foreign Account Disclosure – Possible June 30 Filing Obligation for Certain Funds
62717.
underlying account’s balance at the time of the violation if determined to be willful.98 A U.S. person can be criminally prosecuted and fined either two hundred and fifty thousand dollars and imprisoned for five years or, if the violation occurred in tandem with any other U.S. law violation, the individual will be fined five hundred thousand dollars and imprisoned for ten years.99 The penalties are also applicable if a U.S. person supplies false information or is information is omitted.100

While the statute authorizes the assessment of the maximum penalty for violations, the IRS adopted revised FBAR penalty guidelines in July 2008 in an attempt to encourage non-filers to come forward.101 Under this revision, if the failure to have previously filed the required FBAR was not “willful,” and the threshold conditions were met, the guidelines suggest penalties ranging from five thousand dollars to fifteen thousand dollars depending on the particular amounts.102 If a “willful” non-filer meets the same threshold conditions, the guidelines suggest


99 See id.

100 See Foreign Account Disclosure – Possible June 30 Filing Obligation for Certain Funds and LPs, supra.


102 See Recent Developments Encourage Voluntary Correction to Foreign Financial Bank Account Reporting Violations, (stating the threshold conditions are (1) the person does not have a history of past FBAR penalty assessments; (2) the money passed through any of the foreign accounts associated with the person was not from an
penalties ranging from five percent to fifty percent of the maximum balance in the particular account for the year in question.\textsuperscript{103} The Voluntary Disclosure Initiative, mentioned above, was an additional IRS step aimed at bringing non-filers into the fold by offering a reduced penalty.\textsuperscript{104}

III. THE U.S.-SWISS TAX INFORMATION EXCHANGE AGREEMENTS

A Tax Information Exchange Agreement ("TIEA") is a bilateral agreement between two sovereign countries governing the mutual exchange of information.\textsuperscript{105} The goals behind the U.S.’s initiation of its tax information exchange program were to assure the accurate assessment and collection of taxes, prevent fiscal fraud and tax evasion, and to develop improved sources for tax matters in general.\textsuperscript{106}

\textsuperscript{103} Id.

\textsuperscript{104} See id.

\textsuperscript{105} See Tax Compliance and Enforcement Issues with Respect to Offshore Accounts and Entities, supra at 54.

\textsuperscript{106} See id.
The U.S. entered into a TIEA with Switzerland, a powerhouse in offshore banking, effective December 19, 1997.\textsuperscript{107} Article 26 of U.S.-Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (“Convention”) provided the authorities of the two countries shall exchange tax information as is necessary for the “prevention of tax fraud or the like in relation to taxes which are subject of” the Convention.\textsuperscript{108} This exchange of information includes both civil and criminal matters.\textsuperscript{109}

This section of this article will look at the 2003 changes to the Convention\textsuperscript{110}, followed by a discussion of the policy behind updating the TIEA.\textsuperscript{111}


\textsuperscript{108} Id. at 1.

\textsuperscript{109} See id.


a. The 2003 Changes

Controversy surrounded the definition of “tax fraud” almost immediately upon inception of the Convention.\(^{112}\) Under Swiss law, tax fraud occurs when there is (generally) the use of forged or falsified documents or a scheme of lies to deceive tax authorities.\(^{113}\) However, the U.S. has a more liberal view of what tax fraud entails, including non-filing or the omission of certain income from tax returns.\(^{114}\) The changes employed under the 2003 mutual agreement lean towards the more liberal American outlook.\(^{115}\)

On January 23, 2003 the U.S. and Swiss authorities entered into a mutual agreement that established new guidelines on how to properly implement the Convention.\(^{116}\) It was intended to clarify what behaviors constitute “tax fraud” by outlining fourteen hypothetical situations where recognized tax fraud occurs.\(^{117}\) This list was not meant to be exhaustive and only provides basic

\(^{112}\) Id.

\(^{113}\) Id.

\(^{114}\) See id.


\(^{116}\) Treasury Announces Mutual Agreement with Switzerland Regarding Tax Information Exchange, supra.

guidelines for each country’s constituents and financial institutions. The countries also agreed upon six understandings. The first understanding emphasizes both countries renewed efforts to work together to the greatest extent possible to support the tax administration of both countries. The second understanding states that when information is requested, the statute of limitation of the requesting party applies. The third understanding allows information to be requested for both criminal and civil penalties. The fourth understanding sets forth three examples, provided for in the original agreement, which establish when a country can request information if it is believed or suspected that there is tax fraud being committed. The sixth, 

118 See id.; see generally Treasury Announces Mutual Agreement with Switzerland Regarding Tax Information Exchange, supra.


120 Id. at 1.

121 See id.

122 See id. at 1-2.

123 See id. at 2; Switzerland and United States Sign Tax Information Exchange Agreement, supra at 1 (these examples include (1) conduct established to defraud individuals or companies, even though the aim of the behavior may not be to commit tax fraud; (2) conduct that involves destruction or non-production of records, or the failure to prepare or maintain correct and complete records; and (3) conduct by a person subject to tax in the requesting State that involves the failure to file a tax return that such person is under a legal duty to file, or an affirmative act that has the effect of deceiving the tax authorities).
and last understanding, states these preceding examples will constitute tax fraud under Article 26 of the Convention.124

b. **Policy Behind Updating the TIEA**

TIEAs, entered into mutually, can be an advantageous symbiotic relationship.125 Many countries, including the U.S. and countries within the European Union, believe that Switzerland is a hotbed for maintaining abusive tax avoidance, and the secrecy laws prevent other countries from effectively combating tax fraud.126 Any new changes to the agreement could help Switzerland shake off the recent bad press regarding how their secrecy laws are causing other countries to lose hundreds of millions of dollars in tax revenue.127 Instead of vigorously prosecuting offshore fund holders, a renewed faith in the Swiss banking system could encourage other countries to promote offshore banking, allowing Switzerland to maintain its status quo as an epicenter of banking.128 Conversely, updates to the Convention will help the U.S. increase its


125 See generally Treasury Announces Mutual Agreement with Switzerland Regarding Tax Information Exchange, *supra*.


127 See *id*.

128 *Id*. 
surveillance abilities, assist the government in closing the tax gap, fulfill its TIEA program goals, and recoup millions in lost tax revenue.\textsuperscript{129}

Enacted changes could facilitate more effective tax information exchange between the two countries.\textsuperscript{130} However, despite intentions to improve information sharing, changes may affect how business in Switzerland is run with respect to U.S. and other foreign taxpayers. Any change has the potential to disrupt the cultural landscape of a country that prides itself on banking secrecy and financial security.

IV. \textsc{The UBS Case}

UBS AG ("UBS"), based in Switzerland, is one of the largest financial institutions worldwide.\textsuperscript{131} Effective January 1, 2001, UBS voluntarily entered into a QI agreement with the U.S. Internal Revenue Service.\textsuperscript{132} Like most U.S. QI agreements, UBS agreed to identify and document any customers who held U.S. investments or received U.S. source income in accounts

\textsuperscript{129} See id.

\textsuperscript{130} See Treasury Announces Mutual Agreement with Switzerland Regarding Tax Information Exchange.

\textsuperscript{131} See \textit{Tax Compliance and Enforcement Issues with Respect to Offshore Accounts and Entities}, supra at 2.

\textsuperscript{132} \textit{Id.} at 31; Testimony before the Committee on Finance, U.S. Senate: Tax Compliance – Official Financial Activity Creates Enforcement Issue for the IRS, supra at 10.
maintained with UBS. Therefore, if a U.S. customer refused to be identified under the QI agreement, UBS was required to apply a backup withholding tax at a twenty-eight percent rate on payments made to the customer. Further, UBS was to bar the customer from holding any U.S. investments. UBS failed to uphold its end of the agreement and the U.S. government felt compelled to bring judicial action.

This section will address why UBS became the linchpin in the U.S. attack on bank accounts promoting tax evasion. It will outline the procedure taken against the bank in terms of both criminal and civil judicial action and the policy issues surrounding the litigation. Finally this section will dissect the outcome of the most current civil litigation facing the bank.

\[133\] See Tax Compliance and Enforcement Issues with Respect to Offshore Accounts and Entities, supra at 31.

\[134\] See id.

\[135\] Id.


a. **Why UBS?**

On July 17, 2008, the PSI, still adamantly focused on the fight against tax evasion, released a staff report entitled *Tax Haven Banks and U.S. Tax Compliance* (“2008 PSI Report”). This report, as damning to U.S. offshore tax enforcement as the 2006 PSI report, revealed that many of UBS’s U.S. clients either refused to be identified, to have taxes withheld, or to sell their U.S. assets as required under the standing 2001 QI Agreement. In order to retain the high volume of wealthy U.S. customers, UBS bankers assisted the U.S. taxpayers in concealing the ownership identity of the assets held in offshore accounts by helping to create nominee and sham entities in various non-U.S. jurisdictions, which were then claimed to not be subject to reporting requirements specified under the QI agreement. The report alleges that UBS not only assisted in these tax-evasion schemes, but also purposefully marketed the strategies to wealthy Americans. The 2008 PSI report demonstrated how the U.S. loses

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140 *See id.*

141 *See generally* *Tax Haven Banks and U.S. Tax Compliance*, *supra*.

142 *Id.* at 10.

143 *Id.*
around $100 billion annually due to offshore tax evasion. According to the U.S. Senate and U.S. Department of Justice prosecutor’s investigation, U.S. clients hold about nineteen thousand accounts at UBS, containing an estimated eighteen to twenty billion dollars in assets.

Shortly following the release of this information, Bradley Birkenfeld, an American and a UBS Geneva-based director of wealthy American clients with offshore accounts from 2002-2006, pleaded guilty to the charge of helping American billionaire Igor Olenicoff evade millions of dollars in federal taxes. Birkenfeld’s testimony compounded UBS’s precarious situation. Specifically, the former director testified that UBS bankers used a variety of ruses to court American clients and to help them dodge taxes. UBS advised bankers traveling to the U.S. to tell airport customs the trip was for pleasure and not business. Additionally, the bank urged

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145 See Offshore Tax Evasion Costs U.S. $100 Billion, Senate Probe of UBS, LGT Indicates, supra.


147 Id.

148 Id.

149 See id.
clients to destroy banking records in order to conceal their offshore accounts. Some American clients were even instructed to “stash” watches, jewelry, and artwork bought with money hidden offshore. UBS went so far as to encourage clients to use Swiss credit cards so the IRS could not track purchases. Birkenfeld further stated that in his official position he served as a courier for his clients, getting checks out of the U.S. and depositing them in accounts in Denmark, Switzerland, and Liechtenstein. Birkenfeld testified that he knew he was breaking the law but did so because of the “incentives” UBS offered him. Birkenfeld’s cooperation with the government in the formative stages of the UBS case was vital to the U.S. Federal Government’s tax evasion inquiry.

b. The Case

A little less than a month prior to the 2008 PSI report’s release, on June 22, 2008, the U.S. Federal Bureau of Investigation made a formal request to travel to Switzerland to probe a

150 See id.

151 Id.

152 Id.

153 See id.

154 Id. (stating these incentives came in the form of large bonuses).

155 See id. (“Birkenfeld’s testimony, the centerpiece of a widening investigation into UBS and its wealthy American clients, blew a hole in the wall of secrecy surrounding the world of Swiss banking.”).
multi-million dollar tax evasion case involving UBS.\textsuperscript{156} The UBS fallout subsequently progressed fast and furious.\textsuperscript{157} At the 2008 PSI hearing, held in conjunction with the 2008 PSI Report, Mark Branson, CFO of UBS Global Wealth Management and Business Banking, testified that, in fact, compliance failures might have occurred at UBS.\textsuperscript{158} He pledged that UBS would take progressive action to ensure that the activities identified in the 2008 PSI Report would not continue.\textsuperscript{159} Branson stated that UBS would no longer provide offshore banking services to U.S. customers.\textsuperscript{160} Instead, such customers would only be provided services through U.S. licensed companies.\textsuperscript{161} Additionally, UBS would no longer permit Swiss-based advisors to

\textsuperscript{156} \textit{FBI to Probe Swiss Bank in UBS Tax Dodging Case}, UBS UPDATE (Ass'n of Fin. Prof'ls), June 22, 2008, available at http://afp.google.com/article/ALeqM5jTfwAG7pDZAUUS8_feZQgmnHAeaQ.


\textsuperscript{158} Mark Branson, CFO, UBS Global Wealth Management & Swiss Bank Member of the Group Managing Board, Testimony before the Permanent Subcommittee on Investigations on Homeland Security and Governmental Affairs, United States Senate: Tax Haven Banks and U.S. Tax Compliance (July 17, 2008).

\textsuperscript{159} See id.

\textsuperscript{160} Id.

\textsuperscript{161} See id.
travel to the U.S. to meet with U.S. customers. Branson further pledged that UBS would comply with a John Doe summons relating to the UBS accounts held by U.S. residents.

The following day, on July 18, 2008, a Florida Federal district court granted the IRS permission to issue a John Doe summons to UBS seeking the names of as many as twenty thousand U.S. citizens who were UBS customers that failed to meet reporting or withholding obligations. However, UBS’s legal troubles did not end there. Through a press release, UBS confirmed on November 12, 2008 that Raoul Weil, Chairman and CEO of UBS Global Wealth Management and Business Banking and member of the Group Executive Board, was indicted by a Federal grand jury in the Southern District of Florida in connection with the

162 See id.

163 Id.

164 See Statement of Sen. Carl Levin Introducing the Stop Tax Haven Abuse Act, Part I, supra at 17. (Explaining a John Doe summons is tool used by the IRS in recent years to uncover taxpayers in offshore tax schemes. It is an administrative IRS summons used to request information in cases where the identity of the taxpayer is unknown. To obtain approval of the summons, due to the IRS’s inability to serve the taxpayer, the IRS must show the court, in public filings to be resolved in open court, that: (1) the summons relates to a particular person or ascertainable class of persons, (2) there is a reasonable basis for concluding that there is a tax compliance issue involving that person or class of persons, and (3) the information sought is not readily available from other sources.).


Seemingly in order to put an end to U.S. judicial action, UBS entered into a Deferred Prosecution Agreement with the U.S. Department of Justice on February 18, 2009.\footnote{See Testimony before the Committee on Finance, U.S. Senate: Tax Compliance – Offshore Financial Activity Creates Enforcement Issues for the IRS, supra at 10; see generally \textit{U.S. v. UBS AG} (09-600333-CR-COHN); Press Release, U.S. Dept. of Justice, Office of Public Affairs, UBS Enters into Deferred Prosecution Agreement (Feb. 18, 2009) (on file with the DOJ), available at www.usdoj.gov/opa/pr/2009/February/09-tax-136.html.} UBS, as part of the agreement, agreed to pay $780 million in fines, penalties, interest, and restitution for defrauding the U.S. government by helping U.S. taxpayers hide assets through UBS accounts held in the names of nominees and/or sham entities.\footnote{See Testimony before the Committee on Finance, U.S. Senate: Tax Compliance – Offshore Financial Activity Creates Enforcement Issues for the IRS, supra at 10; see generally \textit{U.S. v. UBS AG} (09-600333-CR-COHN); Press Release, U.S. Dept. of Justice, Office of Public Affairs, UBS Enters into Deferred Prosecution Agreement (Feb. 18, 2009) (on file with the DOJ), available at www.usdoj.gov/opa/pr/2009/February/09-tax-136.html.} A portion of the $780 million monetary penalty, in the amount of $200 million, was to be paid to the U.S. Securities and Exchange Commission in order to settle the SEC’s charge of “acting as an unregistered broker-dealer and
investment advisor” and enforcement action against the bank.¹⁷⁰ Pursuant to the agreement, UBS waived the indictment and consented to the filing of one criminal count charging UBS with conspiracy to defraud the U.S. government and the IRS in violation of U.S. criminal law.¹⁷¹ To the extent UBS meets all monetary and other obligations under the Deferred Prosecution Agreement, the U.S. government will recommend dismissal of the charge.¹⁷² In an unprecedented move made in order to satisfy the agreement obligations, the Swiss Financial Markets Supervisor Authority disclosed to the U.S. government the identities of, and account information for, about two hundred and fifty U.S. customers of UBS’s cross-border business.¹⁷³

The ink had barely dried on the Deferred Prosecution Agreement before, on February 19, 2009, the U.S. government filed a civil suit in a Miami Federal district court against UBS to reveal the names of all fifty-two thousand American customers.¹⁷⁴ The Justice Department’s lawsuit alleged that, together, the bank and the customers conspired to defraud the IRS and the

¹⁷⁰ See UBS Enters into Deferred Prosecution Agreement, supra (stating UBS also consented to the issuance of a final judgment that permanently enjoined the bank).

¹⁷¹ See Tax Compliance and Enforcement Issues with Respect to Offshore Accounts and Entities, supra at 32.

¹⁷² Id.

¹⁷³ See UBS Enters into Deferred Prosecution Agreement, supra.

U.S. Federal Government of legitimately owed tax revenue.\textsuperscript{175} The suit further alleged that the indicated customers had 32,940 secret accounts containing cash and 20,877 accounts holding securities.\textsuperscript{176} The suit stipulates that Swiss-based bankers actively marketed UBS’s services to wealthy U.S. customers within the U.S. borders.\textsuperscript{177} Specifically, the government claims that U.S. contacts occurred through UBS sponsored sporting and cultural events that targeted wealthy Americans.\textsuperscript{178} UBS documents filed with the lawsuit show that UBS bankers came to the U.S. to meet with U.S. clients almost four thousand times a year, a clear violation of U.S. law.\textsuperscript{179} The government states that the Bank trained its officers to avoid detection by U.S. authorities.\textsuperscript{180} In addition to the suit, the U.S. asked a federal judge to enforce the John Doe summons served upon UBS the previous July (2008).\textsuperscript{181}

\textsuperscript{175} Id.


\textsuperscript{178} See id.

\textsuperscript{179} Id.

\textsuperscript{180} Id.

\textsuperscript{181} See \textit{UBS Pressed for 52,000 Names in 2nd Inquiry}, supra.
UBS, backed by the Swiss government, has emphatically indicated it would withhold the names, calling the U.S. demand a “fishing expedition” that would breach bilateral tax agreements and Swiss bank secrecy laws.\textsuperscript{182} The bank believed it had a substantial defense to the enforcement of the John Doe summons and vocalized its intent to vigorously contest the enforcement of the summons in the civil proceeding, as is permitted under the terms of the Deferred Prosecution Agreement.\textsuperscript{183} UBS claimed that the IRS’s summons seeks information regarding a substantial number of undisclosed accounts maintained by U.S. persons at UBS in Switzerland, whose information is protected by Swiss financial privacy laws.\textsuperscript{184} As breaching confidentiality is a criminal offense in Switzerland, to comply with the U.S. summons would mean Swiss UBS employees would have to violate domestic law, resulting in criminal prosecutions in Switzerland.\textsuperscript{185} In response to the summons, the Swiss’s People’s Party called for retaliation against the U.S. and for urgent debate in Parliament on ways to protect Swiss banking secrecy from “further foreign blackmail.”\textsuperscript{186}

\textsuperscript{182}UBS, U.S. Settle Tax Evasion Case, supra.

\textsuperscript{183}See UBS to Fight IRS Search of 52,000 Accounts, supra; see generally Response for UBS AG’s to the IRS’s June 30, 2009 Submission, U.S. v. UBS AG, (July 8, 2009)(No. 1:09-CV-20423-Gold/McAliley).

\textsuperscript{184}See Response for UBS AG’s to the IRS’s June 30, 2009 Submission, supra at 2.


On March 4, 2009, the PSI held another hearing, called the Tax Haven Banks and U.S. Tax Compliance – Obtaining the Names of U.S. Clients with Swiss Accounts (‘‘2009 PSI Hearing’’), directed at enforcing UBS compliance with the John Doe summons.187 According to John DiCicco, Acting Assistant Attorney General, Tax Division, U.S Department of Justice, UBS’s challenge to the government’s motion to enforce the John Doe summons, including an appeal from an adverse ruling, would not be considered a breach of the previously signed Deferred Prosecution Agreement.188 However, if on completion of litigation, the Court were to order UBS to produce the documents sought and hold UBS in contempt for failure to do so, UBS’s noncompliance may be determined to be a material breach of the Deferred Prosecution Agreement.189 If this is found to be the case, the U.S. government is permitted to proceed with the criminal prosecution of UBS.190


189 Id.

190 See id.
Mark Branson also testified at the 2009 PSI Hearing. Branson addressed the progress UBS has made under the requirements of the agreement. He stated that UBS has sought to comply with the John Doe summons without violating Swiss domestic law. According to Branson, Swiss privacy law prohibits UBS from producing responsive information located in Switzerland, which is why UBS has only been able to produce information responsive to the summons that is located in the United States. Branson stated that it is his belief that UBS has currently complied with the summons to the fullest extent possible without subjecting its employees to criminal prosecution in Switzerland. He then emphasized that the U.S.’s continued pressure to enforce the summons would be a violation of the original 2001 QI agreement and the income tax treaty between Switzerland and the U.S.


192 Id.

193 Id.

194 Id.

195 Id.

196 See id.
This warning did not halt U.S. advances in seeking this information. On March 18, 2009, the United States Department of Justice extended its investigation into UBS offshore tax fraud to include independent attorneys and accountants in Switzerland and the United States. Three individuals currently under investigation are a Zurich based accountant who runs a boutique finance and trust company, and a pair of brothers who are attorneys at a law firm located in Zurich and Geneva. A criminal case is being built against these individuals, who are each suspected of having traveled with Swiss UBS bankers to the U.S. to work with American clients to evade U.S. taxes. On April 2, 2009, Steven M. Rubenstein of Boca Raton, Florida, became the first U.S. citizen arrested for tax evasion, allegedly hiding assets at UBS in order to avoid tax collectors. Rubenstein, a yacht company accountant, deposited more than two million dollars in Krugerrand gold coins into his UBS accounts and bought securities worth


198 Id.

199 See Tax Compliance and Enforcement Issues with Respect to Offshore Accounts and Entities, supra at 34 (stating that individual is Beda Singenberger).

200 See id. (stating that the individuals are Matthias W. and Andreas M. Rickenbach).

201 See id.

202 Florida Man First to be Charged in UBS Tax Fraud, UBS UPDATE (Ass’n of Fin. Prof’ls), Apr. 2, 2009, available at http://www.google.com/hostednews/afp/article/ALeqM5i8DNiP43ZSRdO49RQVNiLENiLuSA.
more than 4.5 million Francs.\textsuperscript{203} He is also accused of meeting with UBS Swiss bankers in several locations around South Florida from 2001 to 2008.\textsuperscript{204} On August 10, 2009, Rubenstein signed a plea agreement with the Department of Justice consenting to these charges in exchange for lowered sentencing guidelines.\textsuperscript{205}

Fuel was added to the U.S.’s fire when Jeffrey P. Chernick of Stanfordville, New York, a representative for Hong Kong and Chinese toy manufacturers, pleaded guilty on July 28, 2009 to filing a false tax return by hiding eight million dollars through offshore accounts with UBS and another unnamed Swiss bank.\textsuperscript{206} Chernick testified to details spanning over the past decade regarding the use of offshore accounts in the two banks expressly to avoid taxation.\textsuperscript{207} According to Chernick, the Swiss bankers would remove his name and account numbers from his offshore account statements and would lie to U.S. customs agents regarding their reasons for traveling to the U.S.\textsuperscript{208} He also testified there was a forty-five thousand dollar bribe allegedly

\textsuperscript{203} See id.

\textsuperscript{204} Id.

\textsuperscript{205} See generally Plea Agreement of Defendant Steven M. Rubenfeld, U.S. v. Rubenfeld (Aug. 10, 2009) (No. 09-60166) (S.D. Fla.).


\textsuperscript{207} See UBS Bank Customer Pleads Guilty in Tax Case, supra.

\textsuperscript{208} Id.
paid to a Swiss official on Chernick’s behalf in order to obtain information on the U.S.
investigation into UBS.\textsuperscript{209} Court records document the extraordinary lengths Chernick went to
avoid detection, including setting up a sham $700,000 loan between his company and a second
Hong Kong entity in order to repatriate funds into the U.S. to purchase property for his home in
New York.\textsuperscript{210}

c. \textit{Outcome}

With the August 3 trial date fast approaching, the U.S. government and UBS reported during
the July 31, 2009 status conference meeting with U.S. District Judge Alan Gold that they had
reached an “agreement in principle.”\textsuperscript{211} Terms were not immediately announced, and Judge
Gold stated the parties would likely present a written breakdown at the August 7 status
conference meeting with a final agreement to be approved by the court shortly thereafter.\textsuperscript{212} In
accordance with the latest development, Judge Gold pushed the hearing date back to August 10
to give U.S. and UBS negotiators time to finalize a tentative agreement.\textsuperscript{213}

\begin{flushleft} \textsuperscript{209} \textit{Id.} \end{flushleft}

\begin{flushleft} \textsuperscript{210} See \textit{UBS Bank Customer Pleads Guilty in Tax Case}, supra. \end{flushleft}

\begin{flushleft} \textsuperscript{211} Kevin McCoy, \textit{Justice Dept., UBS Close to Deal on Swiss Tax Secrecy}, USA TODAY, July 31, 2009, available at

\begin{flushleft} \textsuperscript{212} See \textit{Justice Dept., UBS Close to Deal on Swiss Tax Secrecy}, supra. \end{flushleft}
Swiss media reports from July 26 indicated U.S. negotiators expressed a willingness to accept data on a reduced number of accounts held by U.S. citizens.\textsuperscript{214} Under this reported plan, UBS would be required to reveal data only if the client had been visited by Swiss bankers outside the U.S.\textsuperscript{215}

On August 12, 2009, the parties initialed a more substantive agreement, while acknowledging it will “take a little time” to sign this agreement in a final form.\textsuperscript{216} Lawyers involved in the case said the settlement could involve the disclosure of three thousand to more than ten thousand names of American clients suspected of using offshore accounts to evade taxes.\textsuperscript{217} Swiss bank authorities could disclose the names of investors in those accounts without breaching the country’s banking secrecy regime, which expressly carves out an exception for cases involving fraud.\textsuperscript{218} This “fraud exception” was the same principle cited when the bank previously disclosed the names of two hundred and fifty UBS clients in conjunction with the

\textsuperscript{213} See Officials Report ‘Agreement in Principle’ in UBS Dispute, supra.

\textsuperscript{214} Id.

\textsuperscript{215} Id.

\textsuperscript{216} See UBS, U.S. Settle Tax Evasion Case, supra.

\textsuperscript{217} See id.

\textsuperscript{218} See Officials Report ‘Agreement in Principle’ in UBS Dispute, supra.
Deferred Prosecution Agreement.\textsuperscript{219} Additionally, leaked details of what would be in the finalized agreement indicate that the UBS/U.S. settlement may prevent a monetary penalty being levied against the bank.\textsuperscript{220} This is welcoming news to many investors who previously feared UBS would have to pay several billion dollars in order to settle the dispute.\textsuperscript{221}

V. ANALYSIS

As indicated by the various sections of this article, Switzerland, normally considered a bastion of banking secrecy, has come under heavy pressure from the United States, Germany, France and Britain to improve practices in order to crack down on tax evaders.\textsuperscript{222} In response to this pressure, this section will address the changes to the current U.S. Swiss TIEA\textsuperscript{223}, the consequences for the future of Swiss banking privacy law and how it will affect U.S. offshore banking activity\textsuperscript{224}, followed by discussion on the character of policy decisions.\textsuperscript{225}

\textsuperscript{219} Id.


\textsuperscript{221} See id. (stating these fears were fueled by UBS’s June 25 announcement the bank would raise $3.5 billion in a share offering to institutional investors).

\textsuperscript{222} See \textit{U.S., Switzerland Agree to Crack Down on Tax Evaders}, supra.

a. *Likely Changes to the U.S.-Swiss TIEA*

Given the enormous amount of civil and criminal litigation involving Swiss based banks and the United States, coupled with the U.S. government’s unyielding commitment to eliminate abusive offshore tax schemes and offshore accounts which lead to gross tax evasion, changes were bound to be made to the U.S.-Swiss TIEA.\(^{226}\) According to the June 19, 2009 Department of Treasury’s press release, the governments for the United States and Switzerland have concluded negotiations on an amended tax treaty.\(^{227}\) The Swiss Economics Ministry stated the agreement was reached in the final three days of negotiations.\(^{228}\) The countries were then expected to sign the protocol within a few months time,\(^{229}\) once Swiss business and local


\(^{226}\) See generally *id.*; *Switzerland-U.S. Tax Treaty to be Revised*, supra.


\(^{228}\) *U.S., Switzerland Agree to Crack Down on Tax Evaders*, supra.

\(^{229}\) See Switzerland Agree to Increased Tax Information Exchange, supra.
governments are given the chance to comment on the proposed changes. The Federal Council and Parliament will decide if the new agreement is permitted to take effect. Switzerland’s Federal Council and Parliament will decide if the new agreement is permitted to take effect. The Obama administration is focused on pushing initiatives to close loopholes that have allowed U.S. investors to evade taxes using offshore havens; signaling this amendment stands a good chance of being enacted by U.S. Congress and lawmakers. The amendments would revise the existing U.S.-Swiss treaty to allow for a greater exchange of information as permitted by a model tax convention adopted by the Paris-based Organization for Economic Cooperation and Development (“OCED”).

b. *Future of Swiss Banking Privacy vis-a-via the U.S.*

The United States’ case against UBS has strained relations between the U.S and Switzerland because of the blatant challenge to Switzerland’s diligently guarded banking secrecy laws. While the settlement could be viewed as good news for UBS regarding the U.S. legal battleground, the bank could be facing an attack on the home front when the dust finally settles.

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230 *U.S., Switzerland Agree to Crack Down on Tax Evaders, supra.*

231 *See id.*

232 *See id.*

233 *See id.*

234 *See UBS, U.S. Settle Tax Evasion Case, supra.*
in America. In disclosing names, UBS could be facing more civil suits from the account holders whose names were released if they claim that UBS violated Swiss bank secrecy laws by including their names and/or account information in any disclosure. UBS employees may also face criminal prosecution for breaching confidentiality, which is a crime in Switzerland. All of this is likely to cause significant political backlash in Switzerland to defend its sovereignty, especially as it relates to the U.S.

On July 31, 2009, the same day the U.S. and UBS reached an “agreement in principle,” Secretary of State Hilary Clinton met with Swiss Foreign Minister Micheline Calmy-Rey. In response to the UBS litigation, Calmy-Rey stated, “It is about Switzerland’s sovereignty. We want our laws to be respected. It is also about our financial centers and about jobs.” Just prior to the meeting, Calmy-Rey welcomed the news of the developments in the ongoing dispute and expressed her and Clinton’s satisfaction.

\(^{235}\) *Id.*

\(^{236}\) See *id.*

\(^{237}\) See *id.*

\(^{238}\) *Negotiations Continue as UBS Hearing Approaches*, supra.

\(^{239}\) See *id.*

\(^{240}\) *See Officials Report ‘Agreement in Principle’ in UBS Dispute*, supra.
The domestic Swiss banking secrecy laws are a principal reason why Switzerland is such a magnet for foreign banking deposits. The banking sector is such a large employer in Switzerland and such a strong source of pride among the Swiss population, that no Swiss government can today politically eliminate these laws. As such, the political system is likely to continue to respond to the rising political pressure in Switzerland to defend its sovereignty and its domestic banking secrecy laws. The government is likely to seek to strengthen its bank secrecy violation penalties on the one hand, while doing as little as possible to placate the U.S. with respect to U.S. citizens with unreported Swiss accounts.

The Swiss judicial system is also very likely to take umbrage to the U.S. attempt to abrogate its laws. This may take the form of strict and severe enforcement of bank secrecy violation penalties and criminal sentences. The Swiss judiciary has historically often looked at the application of U.S. laws by U.S. Judges in Switzerland as interference with domestic sovereignty, rather than a proper application of U.S. laws to U.S. citizens doing business in Switzerland. However, where such a U.S. case has involved the fraudulent conduct of an U.S. citizen of wealth, the Swiss Courts have been somewhat compliant. In this case, the U.S. is seeking to enforce its laws in Switzerland on U.S. citizens who have properly obtained their wealth, but who have fraudulently not reported such wealth for U.S. tax purposes. As such, the U.S. is attempting to broaden the Swiss idea of fraud beyond what Swiss Courts would normally consider under their definition of “fraud”. The Swiss Courts are very likely to push back against such a broad application.

c. **Is this Good Policy?**
This litigation will more likely than not to begat changes to offshore banking opportunities and banking secrecy laws in addition to the revised U.S.-Swiss TIEA. The U.S. appears to have changed the status quo. The question remains whether this outcome reflects sound policy. This section discusses the effects of this policy, both in terms of interfering with another country’s sovereignty and the true purpose of bringing the UBS case and its subsequent effect.

i. Meddling in Other Country’s Sovereignty

As we all know, the U.S. national flag once said “Don’t Tread on Me.” However, today the U.S. seems to interpret it national interest in terms of projection of U.S. power overseas in addition to protecting its own borders. Now, this foreign projection has extended from military power to taxing power. The U.S. tax system is one of the few “worldwide taxation” systems on Earth. The U.S. also runs an enormous budget deficit. As such, the U.S. has to locate all assets of all citizens that may produce income to ensure compliance of its tax laws and has a budget deficit that puts pressure on tax collectors to do so by any means necessary. This has lead the U.S. to take the position, as in the UBS case, that U.S. taxing authority trumps domestic legal authority in foreign jurisdictions (like Switzerland).

During the Iraq War, Belgian lawmakers took a similar position by seeking to indict high level U.S. government officials, including the Secretary of Defense. On a financial level, what is to prevent another sovereign country from passing laws that interfere with U.S. citizens’ rights in the name of that country’s national interest. In a World that is increasingly connected, can the

\[241 \text{ See Negotiations Continue as UBS Hearing Approaches, supra}\]
U.S. afford to abrogate other country’s laws (especially an ally like Switzerland)? After all, other countries could review the U.S. position in the UBS case and determine they have the right to pass a law that its citizens need not pay U.S. taxes on U.S. source income. If the U.S. can effect a domestic law change that affects a foreign sovereign’s domestic laws, there is no reason that another country could do the same to the U.S. It is not in the U.S. national interest for the U.S. to stand alone in the World with a position that it need not take account of foreign sovereigns’ laws but such sovereigns must take account of the U.S. laws.

ii. True Purpose of the UBS Case and Effect

On the surface, the reason that the U.S. brought the UBS case was to locate the names of U.S. citizens who had unreported foreign bank accounts overseas at UBS. The U.S. actually had a much broader goal as its main purpose in bringing the UBS case. The broader goal was to have a deterrent effect on foreign banks and advisors who assist in creating or facilitating the foreign bank accounts. The myriad network of offshore (i.e., non-U.S.) banks, other financial institutions, advisors, and other facilitators (collectively referred to as “Network”) is so deep and vast that there is no way that the U.S. could effectively locate, bring actions, and enforce its laws, against even a small fraction of the Network. As such, putting UBS personnel in prison and exacting a very large fine against UBS itself was the first, and most important, step in the process. Following that step, getting U.S. taxpayers to voluntarily come forward was the next important step because that had the effect of making the Network aware that U.S. taxpayers may come forward anyway, which may expose the Network to UBS’s fate. The totality of the U.S. attack is such that many foreign banks and other pieces of the Network will no longer accept U.S. citizens as clients. Whereas formerly the common wisdom offshore was that the IRS could not reach foreign jurisdictions to reach the Network, today the opposite conclusion is widely
believed offshore. As such, to the extent the U.S. continues its attack, it is likely to continue to have its Network deterrent goal met.

Obviously, the more press the U.S. receives about cracking down on offshore account holders and the Network, the more of a deterrent effect will also be had on U.S. citizens who might otherwise contemplate opening up an unreported foreign bank account. If the IRS and the U.S. government get the names, whether or not they fall within the Swiss “fraud exception,” either by court order or the settlement, this will be a very large weapon in the U.S. government’s arsenal.\textsuperscript{242} Lastly, with increased attention paid to offshore accounts, there may be a limit on the ability of owners to access their money.\textsuperscript{243}

VI. CONCLUSION

The U.S. had a very important goal in bringing the UBS case: deterring taxpayers from opening unreported foreign bank accounts and deterring foreign banks and advisors from assisting U.S. taxpayers in doing so. The PSI report spelled out that U.S. citizens have made extensive use of offshore tax havens to evade taxes and that traditional law enforcement is unable to control such misconduct.\textsuperscript{244} It makes sense that the largest offshore banking

\textsuperscript{242} See UBS Case Could be Major Victory for IRS, supra.

\textsuperscript{243} Id. (Mark Matthews, former chief of the IRS Criminal Investigation Division stated, “No matter the results of pending litigation, taxpayers with unreported offshore accounts will still face potential further criminal actions if they conduct financial transactions in order to hide the money or sneak it back into the U.S.”).
jurisdiction with bank secrecy laws, Switzerland, would be the initial target of the U.S. probe. In conjunction with the criminal and civil probe of UBS, it also stands to reason that the U.S. would seek to get a more favorable TIEA in place with Switzerland\textsuperscript{245}.

The problem with the U.S. attack on UBS is not its goals, but rather its methods. The U.S. has traditionally been steadfast in protecting itself from being significantly effected by laws of other sovereign nations that contradict U.S. law and/or interests. Given this position, the U.S. appears to be trying to have it both ways with the rest of the World – they must follow U.S. laws but they should not attempt to make us follow their laws. Given this contradiction, it is understandable that the Swiss have are concerned that the U.S. is not respecting Swiss domestic law. The U.S., after all, has personal jurisdiction over its own citizens and therefore should be able to use other means of tax enforcement that respect the domestic laws of another sovereign country, especially an ally such as Switzerland.


\textsuperscript{245} See \textit{U.S., Switzerland Agree to Crack Down on Tax Evaders}, supra.