

## SECRECY IN LIMBO: WHAT THE MOST RECENT SETTLEMENT WITH THE IRS MEANS FOR UBS AND THE REST OF THE SWISS BANKING INDUSTRY

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### INTRODUCTION

Over the past century, Switzerland has developed a highly secure banking system predicated on banking laws that stress restriction and secrecy.<sup>1</sup> Historically, Swiss banks have maintained the strictest privacy for their clients by identifying the accounts only by a generated number.<sup>2</sup> The Swiss have gained a reputation for their ability to afford the utmost honesty, secrecy, and protection for their clients.<sup>3</sup> Amid concerns of terrorism, money laundering, and tax fraud and evasion, Swiss Banks have faced growing pressure to reform and loosen the protection over accounts that the bank laws provide.<sup>4</sup> An estimated one-third of all cross-border private banking is managed by a Swiss bank, totaling billions of dollars in assets held in a relative lack of scrutiny.<sup>5</sup> Tax avoidance benefits exist for corporations as well as individuals, and in the 1990's both R.J. Reynolds and Phillip Morris shifted their tobacco headquarters from the United States to Switzerland to maximize the tax benefits provided by the Swiss legal and banking system.<sup>6</sup> More recently, UBS, one of Switzerland's largest banks, has been under scrutiny by the United States regarding the identity of the US account holders overseas.<sup>7</sup>

Part I of my paper will introduce the origins and backgrounds of Swiss Bank Secrecy laws and provide some context for the discussion that follows. Part II examines the history of banking secrecy in Switzerland and how it has helped to shape the various treaties that help to enforce the secrecy as well as facilitate information sharing amongst various nations. Further, the evolution of these treaties today have impacted the current events surrounding these laws and have laid the groundwork for the new settlements reached today. Part III of my paper examines the current legal battle between UBS and the IRS and United States Department of Justice over the turnover of client data pursuant to a deferred prosecution agreement. A brief

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<sup>1</sup> Greg Brabec, *The Fight for Transparency: International Pressure to Make Swiss Banking Procedures Less Restrictive*, 21 TEMP. INT'L & COMP L.J. 231 (2007).

<sup>2</sup> Urs Martin Lauchli, *Swiss Bank Secrecy With Comparative Aspects to the American Approach*, 42 ST. LOUIS U. L.J. 865, 872 (1998).

<sup>3</sup> *Id.*

<sup>4</sup> Bloomberg News, *Swiss Face Pressure from Europe to Loosen Bank Secrecy Laws*, N.Y. TIMES, Sept. 7, 2002, at C3.

<sup>5</sup> Brabec, *supra* note 1, at 251.

<sup>6</sup> *Id.*

<sup>7</sup> Lynnley Browning, *U.S. Extends its Inquiry of Offshore Tax Fraud*, N.Y. TIMES, Mar. 19, 2009, at B3; See also David S. Hilzenrath, *Pressure Builds on UBS over Secrecy*, WASH. POST, Mar. 5, 2009, at D1.

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background on the various cases against UBS bankers that led to the eventual lawsuit against UBS, helps set the stage for an analysis of the agreement. Part IV discusses what the ruling by the Swiss Court in Bern and Swiss Parliaments recent acceptance means for the status of the agreement and what may happen to UBS in the United States and abroad. Finally, Part V summarizes the concepts discussed and proposes the next step in gaining greater transparency while still allowing Switzerland to maintain its historical identity of strong banking secrecy and reliability.

UBS AG is a premier financial service firm and the world's largest manager of private wealth assets.<sup>8</sup> Formed in 1998 by the merger of the Union Bank of Switzerland and the Swiss Bank Corporation and headquartered in Basel and Zurich, UBS currently provides its global client base with wealth management, investment banking, asset management and business banking services.<sup>9</sup> Additionally, UBS is the leader of retail and commercial banking services in Switzerland.<sup>10</sup> UBS, like all Swiss banks, is governed by the same set of banking laws that established the secret nature of the industry.<sup>11</sup> Recently, the Swiss have started to receive increased pressure from numerous governments and governmental agencies to make the banking laws more transparent. The Internal Revenue Service ("IRS"), along with other international pressure, has been attempting to gain access to the accounts of American clients in UBS due to concerns about money laundering and tax evasion.<sup>12</sup> In the past few years, the IRS has embarked on an aggressive campaign to combat tax evasion and claim millions of dollars in unreported US income.<sup>13</sup> As part of these increased efforts to seek out and prosecute tax evasion, the IRS began a lengthy legal dispute with Switzerland and UBS.<sup>14</sup>

Early last year UBS agreed to pay \$780 million in fines, penalties, interest, and restitution to the American government as part of entering into a deferred prosecution agreement ("DPA") on charges of conspiring to defraud the United States by impeding the work of the IRS.<sup>15</sup> As part of this DPA, UBS acknowledged and admitted that from 2000 through 2007 certain private bankers and account managers actively assisted and/or facilitated a number of United States taxpayers in establishing accounts with UBS in a manner that would conceal and shield their ownership and interest in these accounts.<sup>16</sup> To this end, these bankers and managers also assisted in the creation and establishment of accounts in the names of offshore companies, allowing US taxpayers to evade the strict IRS reporting requirements and trade in securities, among other financial transactions, that are allowed with a bank account.<sup>17</sup> Further, The Swiss Financial Markets Supervisory Authority ("FINMA") gave the United States government the identities and account information for certain United States customers.

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<sup>8</sup> UBS Homepage - About Us, <http://www.ubs.com/1/e/about.html> (last visited Dec. 1, 2010).

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> See Alison Langley, *Change, the New Face of Private Swiss Banking*, N.Y. TIMES, Dec. 6, 2002, at W1.

<sup>13</sup> Lynnley Browning, *Pressured by I.R.S., UBS is Closing Secret Accounts*, N.Y. TIMES, Jan. 9, 2009, at B1.

<sup>14</sup> Dan Lalor, *U.S. Files Formal Request for UBS Client Data*, REUTERS, Aug. 31, 2009, <http://www.reuters.com/article/idUSLV34741020090831>.

<sup>15</sup> David S. Hilzenrath & Zachary A. Goldfarb, *UBS to Pay \$780 Million over U.S. Tax Charges*, WASH. POST, Feb. 19, 2009, at D1.

<sup>16</sup> Lawrence S. Feld, *Undeclared Foreign Accounts, Tax Fraud and the UBS Prosecutions: Is a Voluntary Disclosure to the IRS the Right Approach?*, 50 Tax Management Memorandum (BNA) 227 (2009).

<sup>17</sup> *Id.*, Other examples of transactions include making loans, transferring assets, and using debit and credit cards linked to these offshore accounts.

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The Securities and Exchange Commission (“SEC”) charged UBS with “acting as an unregistered broker-dealer and investment advisor” and filed an enforcement action against the corporation.<sup>18</sup> Soon after, the U.S. government filed a “John Doe” suit against UBS to reveal the names of all 52,000 American customers, alleging that the bank and its customers conspired to defraud the IRS and federal government of legitimately owed tax revenue.<sup>19</sup>

Additionally, the lawsuit alleges that UBS “engaged in cross-border securities transactions in the United States that it knew violated U.S. security laws” by assisting hundreds of U.S. taxpayers in setting up dummy offshore companies to make it simpler to avoid reporting obligations under U.S. tax laws.<sup>20</sup> On August 19, 2009, UBS announced a settlement agreement with the IRS regarding the John Doe summons stating that both parties had “agreed on an information exchange mechanism that is intended to achieve the U.S. tax compliance goals of the UBS Summons while also respecting Swiss sovereignty and as contemplated in the US-Switzerland Agreement, the IRS will deliver to the Swiss Federal Tax Administration a request for administrative assistance, . . . seeking information with regard to accounts of certain U.S. persons maintained at UBS in Switzerland.”<sup>21</sup> The submission by UBS to the American tax authorities was an unprecedented move in “piercing the veil of bank secrecy.”<sup>22</sup> This settlement will potentially have far reaching consequences for Swiss banks, as the IRS seeks to use it as a road map in its continued effort to prosecute tax evasion by U.S. taxpayers using offshore accounts.<sup>23</sup> However, a top Swiss court dealt a blow to U.S. efforts when it ruled that Switzerland cannot hand over files on 26 suspected American tax evaders because their failure to properly declare assets doesn’t constitute fraud under Swiss law.<sup>24</sup> The Swiss government sought to reopen talks with the United States in an attempt to salvage the settlement that requires the handover of the suspected American tax evaders.<sup>25</sup> This was a startling reversal, which potentially could have created negative consequences for UBS and lead to a new investigation by the Justice Department, but was not such a surprise after two lower Swiss courts ruled that the disclosure of client names was illegal because it violates the Swiss secrecy laws.<sup>26</sup>

With the continued pressure of the international community on the Swiss Banking industry<sup>27</sup>, the Swiss Parliament finally approved the treaty paving the way for the standoff to

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<sup>18</sup> U.S. Dep’t of Justice News Release No. 09-136, UBS Enters into Deferred Prosecution Agreement (Feb. 18, 2009), <http://www.usdoj.gov/opa/pr/2009/February/09-tax-136.html>.

<sup>19</sup> U.S. Dep’t of Justice News Release No. 09-139, United States Asks Court to Enforce Summons for UBS Swiss Bank Account Records (Feb. 19, 2009), <http://www.usdoj.gov/opa/pr/2009/February/09-tax-139.html>.

<sup>20</sup> *Id.*

<sup>21</sup> UBS and IRS Settlement Agreement (2009), [http://www.irs.gov/pub/irs-drop/bank\\_agreement.pdf](http://www.irs.gov/pub/irs-drop/bank_agreement.pdf)

<sup>22</sup> Lynnley Browning, *Names Deal Cracks Swiss Bank Secrecy at Swiss Banks*, N.Y. TIMES, Aug. 20, 2009, at A1, (quoting Douglas Shulman, IRS Commissioner).

<sup>23</sup> *Id.*

<sup>24</sup> Lynnley Browning, *Swiss Back Away From Deal to Give Names of Rich UBS Clients to U.S.*, N.Y. TIMES, Jan. 28, 2010, <http://www.nytimes.com/2010/01/28/business/global/28ubs.html>.

<sup>25</sup> *Id.*, “While the Swiss cabinet, known as the Swiss Federal Council, said in a statement that it would continue talks with the United States on the matter, it said there was a risk that the United States would resume civil proceedings filed against UBS in a Florida court last year.”

<sup>26</sup> *Id.*, see also David Voreacos, Carlyn Kolker, and Ryan J. Donmoyer, *UBS Tax Ruling May Prompt New U.S. Legal Battle*, BUSINESSWEEK, Jan. 28, 2010, <http://www.businessweek.com/news/2010-01-28/ubs-tax-ruling-may-prompt-fresh-u-s-legal-battle-update2-.html>.

<sup>27</sup> Browning, *supra* note 24.

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end and allowing UBS to complete the handover of the client data.<sup>28</sup> Currently, the United States authorities are waiting to receive the rest of the account information. What does the recent litigation and settlement with the IRS mean for the future of the secretive banking laws? Did the IRS damage the ability of the Swiss to protect their clients, or does the settlement allow for greater cooperation beyond the treaties already in place and usher in a new age of controlled and regulated privacy for Swiss bank clients? Further, what did the ruling by the Swiss courts mean for the future of the settlement, and what happens now that Parliament has approved it? An evaluation of the history of Swiss banking laws and the subsequent various treaties on evidence sharing and judicial assistance is significant to better understand the implications of these events and what the future holds.

### ORIGINS OF SWISS BANKING SECRECY

#### History of Secrecy

Switzerland's banking laws date back to the Eighteenth and Nineteenth centuries when the first private Swiss savings bank was established.<sup>29</sup> Switzerland is divided into 26 sovereign Cantons that, as member states, form the federal state of Switzerland.<sup>30</sup> Cantonal bank laws governed the Swiss banks until 1934, when the Federal Banking Law was enacted.<sup>31</sup> As a result of the harsh economic hardships facing war torn Europe after World War I due to exchange controls and hyperinflation, individuals began to deposit their money in banks outside the fragile economies of their home nation.<sup>32</sup> The Nazi Regime rose to power in Germany in 1933 and upon doing so, sought to tighten German borders and halt the export of money to other countries.<sup>33</sup> In order to achieve this goal, the Nazis enacted regulations requiring all citizens to declare all worldwide assets held outside Germany or face a death sentence.<sup>34</sup> Following the execution of three German citizens in 1934, Switzerland acted quickly and codified the "secrecy customs of Swiss Bankers" in federal law.<sup>35</sup>

The Federal Parliament passed the Swiss Federal Banking Act of 1934, which identified and established regulations for the entire banking industry as well as government regulators.<sup>36</sup> The primary text of this law, Article 47, established specific duties for bankers,

<sup>28</sup> Klaus Wille, *Swiss Parliament Approves UBS Treaty, Ends Standoff*, BLOOMBERG, June. 17, 2010, <http://www.businessweek.com/news/2010-06-17/swiss-parliament-approves-ubs-treaty-ends-standoff-update2-.html>.

<sup>29</sup> Werner de Capitani, *Bank Secrecy Today*, 10 U. PA. J. INT'L BUS. L. 57, 58-9 (1988).

<sup>30</sup> Lauchli, *supra* note 2, at 866.

<sup>31</sup> Bundesgesetz über die Banken und Sparkassen [Bankengesetz], Systematische Sammlung des Bundesrechts [SB], Loi fédérale sur les banques et les caisses d'épargne, Recueil systématique du droit fédéral [Df], Legge federale su le banche e le casse di risparmio, Raccolta sistematica del diritto federale [Df], SR 952.0, RS 952.0 (Switz.) [hereinafter Federal Laws on Banks and Savings Banks].

<sup>32</sup> See Mark K. Gyandoh, *Foreign Evidence Gathering: What Obstacles Stand in the Way of Justice*, 15 TEMP. INT'L & COMP. L.J. 81, 91 (2001).

<sup>33</sup> See Brabec, *supra* note 1, at 233; see also Jennifer A. Mencken, *Supervising Secrecy: Preventing Abuses Within Bank Secrecy and Financial Privacy Systems*, 21 B.C. INT'L & COMP. L. REV. 461, 468 (1998).

<sup>34</sup> The Nazi statute stated: "Any German national who, deliberately or otherwise, activated by a base selfishness or other vile motive, has amassed his wealth abroad or left capital outside the country, shall be punished by death." See Mencken, *supra* note 33, at 468 n.60. (quoting Edouard Chambost, *Bank Accounts: A World Guide to Confidentiality* 7-8 (1983).

<sup>35</sup> Mencken, *supra* note 33 at 468.

<sup>36</sup> See Brabec, *supra* note 1, at 234-5

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including measures to tighten security to ensure client confidentiality, and also instituted criminal penalties for violators.<sup>37</sup> In 1935, Switzerland expanded the scope of the Office of the Federal Attorney and enacted the Law Concerning the Protection of the Swiss Confederation<sup>38</sup> in an effort to further bolster Swiss banks and protect the sovereignty of the Swiss economy.<sup>39</sup> Switzerland was concerned with not only with protecting its own citizens, but also protecting foreign nationals who trusted the Swiss and opened bank accounts at Swiss national banks and wanted to maintain their assets secretly without fear of facing a death sentence.<sup>40</sup> These initial laws were enacted to prevent inquiries from Nazi Germany into the accounts at Swiss banks, but are actually rooted in different fundamental view of privacy than exists here in the United States.<sup>41</sup>

The notion of Swiss bank secrecy is derived from a “subset of personal rights, professional secrecy and business secrecy.”<sup>42</sup> The Swiss Civil Code governs the right of privacy and sets forth general guidelines and obligations governing how people interact with the lives of others.<sup>43</sup> Specifically, Article 28 creates a legal cause of action and imposes a judicial intervention for anyone who “is illegally deprived of his right to privacy.”<sup>44</sup> The right to privacy in Switzerland applies to an individual’s personal information as well as that persons financial and business information.<sup>45</sup> Conversely, the American legal system does not consider financial information part of the privacy rights, and only includes those fundamental rights established by the United States Supreme Court.<sup>46</sup> American law acknowledges that bankers owe a duty to their customers to not disclose information to a third party, however it does not provide a veil of secrecy for government inquiries or recognize a banker-depositor privilege similar to the Swiss.<sup>47</sup> American law actually requires banks to collect information from customers deemed critical for law enforcement and prosecution purposes.<sup>48</sup> The Currency and Foreign Transaction Report Act, or the Bank Secrecy Act of 1970, requires mandatory reporting by banks.<sup>49</sup> While established Swiss law mandates penalties for violations of bank secrecy, American banks face criminal and civil penalties for failing to comply with the reporting requirements.<sup>50</sup>

<sup>37</sup> Schweizerisches Strafgesetzbuch [StGB], Code penal suisse [Cp], Codice penale svizzero [Cp], SR. 311.0, RS 311.0, art. 162 (Switz.) [hereinafter “Swiss Penal Code”].

<sup>38</sup> See also Brabec, *supra* note 1, at 234.

<sup>39</sup> Lauchli, *supra* note 2, at 866.

<sup>40</sup> *Id.*

<sup>41</sup> Brabec, *supra* note 1, at 234.

<sup>42</sup> Lauchli, *supra* note 2, at 867.

<sup>43</sup> Schweizerisches Zivilgesetzbuch [ZGB], Code civil suisse [Cc], Codice civile svizzero [Cc], SR 210, RS 210, as amended by RO 1984, at 778-82, arts. 27 & 28 (Switz.) [hereinafter “Swiss Civil Code”].

<sup>44</sup> Swiss Civil Code, Article 28, paragraphs 1 and 2 state: “Whoever is illegally deprived of his right to privacy may obtain the intervention of a judge against whomever participates in the offense. The offense is illegal whenever it is not justified by the consent of the victim, by a prevailing public or private interest, or by the law.” *Id.* (quoted in Lauchli, *supra* note 2, at 867 n.14).

<sup>45</sup> Brabec, *supra* note 1, at 235.

<sup>46</sup> The United States Supreme Court has ruled on specific rights of privacy including the right to marry, have an abortion, and rear children among others. *Id.* at 235-8; see also Lauchli, *supra* note 2, at 867.

<sup>47</sup> Lauchli, *supra* note 2, at 877.

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> *Id.* These civil and criminal penalties are examined further in depth infra at Section III of this Note.

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The system of professional secrecy in Switzerland assumes that bankers are given the same level of trust and confidence from their customers as lawyers and clerics receive from their own patrons.<sup>51</sup> Under this assumption, it is clear why the Swiss system provides methods for preventing the release of information considered private. For instance, Article 28, specifically section (a), provides a customer with the ability to petition a judge to bar a bank from releasing private information, while Article 27 of the Code of Obligations<sup>52</sup> provides that a customer may sue a bank for damages under Articles 41 and 49 stemming from the violation of the secrecy element and the surrender of information deemed private.<sup>53</sup> The Code of Obligations does not specifically mention the duty of secrecy that banks owe to its clients; however, it does spell out the contractual undertakings an agent has to carry out to conduct business on behalf of a principal.<sup>54</sup> The relationship between banks and their customers are viewed in this very manner, and therefore, the Code of Obligations and the duty of care and execution of services it provides applies to bank patrons.<sup>55</sup> In fact, the banker's obligation to maintain confidentiality of all client-based information is a condition that is implied with the signing of a deposit contract.<sup>56</sup> It follows that the dissemination of any confidential information by the bank violates the duty of care owed to its patrons and that the customers are granted methods of relief from the Civil Code and Code of Obligations.<sup>57</sup>

While the Code of Obligations never specifically mentions bank secrecy, the Swiss Federal Banking Law expressly mentions bank secrecy and lays out guidelines for criminal prosecution. It has been suggested that by allowing criminal penalties for bank secrecy, the legislature did not intend to provide preferential treatment for one type of professional secrecy, but rather wanted to stress the importance of bank secrecy to the public and economic interests of Switzerland.<sup>58</sup> Specifically, Article 47 of the Federal Banking Law, states that whomever divulges a secret entrusted to them by the nature of their professional banking capacity and duties, and whoever tries to induce others to reveal professional secrets, is subject to punishment by a combination of imprisonment and fines depending on intent, negligence, frequency of offenses, and other criteria.<sup>59</sup>

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<sup>51</sup> Paolo S. Grassi & Daniele Calvarese, *The Duty of Confidentiality of Banks in Switzerland: Where It Stands and Where It Goes. Recent Developments and Experience. The Swiss Assistance to, and Cooperation with the Italian Authorities in the Investigation of Corruption among Civil Servants in Italy (the "Clean Hands" Investigation): How Much is Too Much?*, 7 PACE INT'L L. REV. 329, 337-39 (1995).

<sup>52</sup> Schweizerisches Obligationenrecht [OR], Code des obligations [Co], Codice delle obbligazioni [Co], SR 220, RS 220 (Switz.) [hereinafter "Swiss Code of Obligations"].

<sup>53</sup> Lauchli, *supra* note 2, at 867.

<sup>54</sup> *Id.*, See Articles 394 to 406 of the Swiss Code of Obligations for more specific guidelines and duties.

<sup>55</sup> *Id.*

<sup>56</sup> *Id.* at 867-8.

<sup>57</sup> *Id.*

<sup>58</sup> *Id.*

<sup>59</sup> Federal Laws on Banks and Savings Banks, art. 47 states: (1) Imprisonment of up to three years or fine will be awarded to persons who deliberately: (a) disclose a secret that is entrusted to him in his capacity as body, employee, appointee, or liquidator of a bank, as body or employee of an audit company or that he has observed in this capacity; (b) attempts to induce such an infraction of the professional secrecy. (2) Persons acting with negligence will be penalized with a fine of up to 250'000 francs. (3) In the case of a repeat within five years of the prior conviction, the fine will amount to 45-day rates at a minimum. (4) The violation of the professional secrecy also punishable after conclusion of the licensed or official responsibilities or the professional exercising duties is punishable. (5) The federal and cantonal provisions on the duty to provide evidence or on the duty to provide information to an authority remain reserved. (6) Prosecution and judgment of offences pursuant to these

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The violation of professional secrecy remains punishable even after the termination of employment, conclusion of the licensed or official relationship, or even the cessation of business activities in a given profession, solidifying the importance of maintaining professional secrets at all times.<sup>60</sup> This also extends to the concept of business secrets, which includes any public or private “facet of economic life” that the Swiss have an interest in.<sup>61</sup> Inclusion of private economic secrets in the broad definition of business secrets is a way that the Swiss protect their states’ economy and interests from potential breaches of privacy.<sup>62</sup> The obligation of secrecy for the banker extends to all that is confided in him and all that is learned in the everyday practice of the banking profession.<sup>63</sup> As such, any relationship to a bank and any information pertinent to that relationship, whether it is the nature of the relationship, information concerning financial situations, third party relationships, or possible relationships with other financial institutions, among others, are all protected by bank secrecy.<sup>64</sup>

The inherent protection of all information sought by other parties, including the government, into financial and business secrets is the driving force behind the Swiss bank secrecy culture.<sup>65</sup> Banks in Switzerland and their employees are legally bound to protect and maintain the secrecy and confidentiality of all of their clients and patrons.<sup>66</sup> Without limitations on secrecy, and methods of gaining and sharing information pertaining to criminal activities, the banking industry in Switzerland would be no better than a regular tax haven where taxpayers hide their money to avoid payment of taxes to their home nation. Various types of treaties have been created and modified in order to facilitate the sharing of information and judicial assistance between different nations.

**Treaties: Enforcement of Secrecy and Information Sharing**

In the middle of the 20th Century, it became clear that an era of expanded communication and international relations created the necessity for treaties amongst nations concerning legal cooperation and the sharing of evidence.<sup>67</sup> In order to facilitate the gathering of foreign evidence, a large group of nations, led by the United States, negotiated and signed in The Hague on 18 March 1970.<sup>68</sup> The Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters, commonly referred to as the Hague Evidence Convention, allows transmission of Letters of Request<sup>69</sup> from one signatory state, where the evidence is sought, to another signatory state, where the evidence is located, without providing remedy or recourse to consular and diplomatic channels.<sup>70</sup> When the treaty was ratified, Switzerland was

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provisions are incumbent upon the cantons. The general provisions of the Swiss Penal Code are applicable. Federal Laws on Banks and Savings Banks, *supra* note 31, at art. 47.

<sup>60</sup> *Id.*

<sup>61</sup> Lauchli, *supra* note 2, at 869.

<sup>62</sup> *Id.*

<sup>63</sup> Federal Laws on Banks and Savings Banks, *supra* note 31, at art. 47.

<sup>64</sup> Lauchli, *supra* note 2, at 869.

<sup>65</sup> *Id.*

<sup>66</sup> *See Id.*

<sup>67</sup> Gyandoh, *supra* note 32, at 87.

<sup>68</sup> *Id.*

<sup>69</sup> Letters of Request are similar to Letters Rogatory, which are formal requests from a court to a foreign court seeking some type of judicial assistance, usually in service of process and evidence matters.

<sup>70</sup> Convention of 18 March 1970 on the Taking of Evidence Abroad in Civil or Commercial Matters Full Text, [http://www.hcch.net/index\\_en.php?act=conventions.text&cid=82](http://www.hcch.net/index_en.php?act=conventions.text&cid=82).

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not a party to the convention; in fact, Switzerland did not ratify the Hague Evidence Convention until November 2, 1994.<sup>71</sup> The convention was not the first of its kind, and certainly not the last, but the importance of “codifying an international protocol acceptable to civil law and common law countries for the procurement of evidence in the signatory nations” was a vital step toward the evidence and information sharing treaties we have today.<sup>72</sup>

While the treaty expanded the scope of evidence sharing among signatory countries, it also had the opposite effect.<sup>73</sup> The agreement allows for signatory countries to decline requests for discovery, especially pertaining to documents sought before a trial, greatly impeding the efforts of the United States on many occasions due to a perceived broad reach of American discovery rules.<sup>74</sup> The denial of a request for evidence by an American court or agency is referred to as “blocking” and usually occurs where a country has primary differences in the discovery process than that of the requesting country.<sup>75</sup> The United States has been on the receiving end of many blocked requests due to the aggressive and broadly inclusive nature of American discovery, which is opposed by countries like France and England.<sup>76</sup> Blocking statutes fit into three basic categories.<sup>77</sup> The first category includes non-disclosure laws that were not created to specifically impede litigation stemming from a specific country, such as the Swiss banking secrecy statutes at issue here.<sup>78</sup>

The second category includes foreign laws that create extensive protection for categories of documents or grant a government official discretion to approve requests.<sup>79</sup> A good example of these types of blocking statutes is the British Protection of Trading Interests Act, which grants the British Secretary of State the broad discretion to prohibit compliance with requests that “infringe on either the sovereignty or the security of the United Kingdom.”<sup>80</sup> The third category is the most straightforward, and includes statutes enacted to specifically frustrate foreign claims.<sup>81</sup> For example, in an effort to cripple American antitrust litigation pertaining to uranium cartels, Canada passed the Uranium Information Security Regulations, which precluded the production of information about uranium sales.<sup>82</sup>

In order to assist in the enforcement of the blocked request, many countries impose criminal penalties on parties that violate the order and produce documents for foreign litigation.<sup>83</sup> These criminal sanctions generally involve fines and possibility of jail time.<sup>84</sup> For example, Swiss law imposes a penalty of 50,000 Swiss francs and possible jail time of up to six months.<sup>85</sup> Aware of these laws, some domestic companies have exploited the loopholes created by sending documents and information overseas to protect themselves in case a law-

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<sup>71</sup> Convention of 18 March 1970 on the Taking of Evidence Abroad in Civil or Commercial Matters Status Table, [http://www.hcch.net/index\\_en.php?act=conventions.status&cid=82](http://www.hcch.net/index_en.php?act=conventions.status&cid=82).

<sup>72</sup> Gyandoh, *supra* note 32, at 87.

<sup>73</sup> *Id.*

<sup>74</sup> *See Id.*

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> David E. Teitelbaum, *Strict Enforcement of Extraterritorial Discovery*, 38 STAN. L. REV. 841, 847 (1986).

<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> *Id.* at 848.

<sup>81</sup> *Id.*

<sup>82</sup> *Id.* at 848-9.

<sup>83</sup> Gyandoh, *supra* note 32, at 88.

<sup>84</sup> *Id.*

<sup>85</sup> *See Trade Dev. Bank v. Cont'l Ins. Co.*, 469 F.2d 35, 39 (2d Cir. 1972).



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suit arises.<sup>86</sup> Other companies have even gone so far as to collude with foreign governments to protect potentially sensitive information.<sup>87</sup> Unfortunately, The Hague Evidence Convention only governs the sharing of evidence in civil and commercial matters, creating a void concerning criminal matters. In order to facilitate judicial cooperation in criminal matters, countries have entered into various other treaties.

Under the same notions that led to the creation of evidence treaties for civil and commercial matters, many countries sought to form agreements known as Mutual Legal Assistance in Criminal Matters Treaties (“MLAT”), which codify rules and regulations for the gathering and submission of evidence in criminal matters.<sup>88</sup> An MLAT is generally formed to foster compulsion amongst the signatory countries to assist in criminal matters upon request.<sup>89</sup> General exceptions to this assistance are matters concerning political or military offenses and potential state secrets and confidential materials.<sup>90</sup> Many agree that the MLAT is a much more efficient and productive system than the old letters rogatory, since the MLAT procures assistance at a police and law enforcement level rather than diplomatic or prosecutorial level.<sup>91</sup> The MLAT essentially streamlines the Letters Rogatory, skipping several bureaucratic and diplomatic channels and going straight from one authority to another.<sup>92</sup>

Historically, until the 1934 Federal Banking Act, Swiss authorities proceeded to process any American request for evidence or information under the pertinent cantonal civil procedure law.<sup>93</sup> Since cantonal law is different in each of the 26 cantons, many confusing standards existed due to the varying rules.<sup>94</sup> In order to facilitate efficient and productive cooperation between the United States and Switzerland, the countries entered into the Treaty on Mutual Assistance in Criminal Matters<sup>95</sup> on May 25, 1973, which was the first treaty of its kind between two countries with different legal systems.<sup>96</sup>

Each MLAT that a country enters in to is different from one another, since each MLAT must take into consideration unique circumstances and concerns that each country has.<sup>97</sup> The Swiss sought to create a treaty that mirrored the European Convention on Mutual

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<sup>86</sup> Gyandoh, *supra* note 32, at 88.

<sup>87</sup> Teitelbaum, *supra* note 77, at 851; *see, e.g.*, SEC v. Banca Della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981) (affirmative use of Swiss secrecy laws to evade U.S. securities law); General Atomic Co. v. Exxon Nuclear Co., 90 F.R.D. 290 (S.D. Cal. 1981) (company policy of sending documents to Canada and alleged collusion with the government).

<sup>88</sup> Gyandoh, *supra* note 32, at 89.

<sup>89</sup> *Id.*

<sup>90</sup> *Id.*

<sup>91</sup> *Id.*; *see also* Bruce Zagaris and Jessica Resnick, *The Mexico-U.S. Mutual Legal Assistance in Criminal Matters Treaty: Another Step Toward Harmonization of International Law Enforcement*, 14 ARIZ. J. INT’L & COMP. L. 1, 10 (1997).

<sup>92</sup> *See* Gyandoh, *supra* note 32, at 89.

<sup>93</sup> Jennifer Hanneman, *The Evolution of Cooperation Between Authorities in the United States and Switzerland in the Enforcement of Insider Trading Laws*, 12 WIS. INT’L L.J. 247, 253 (1997).

<sup>94</sup> *Id.*

<sup>95</sup> Treaty on Mutual Assistance in Criminal Matters, May 25, 1973, U.S.-Switz., 27 U.S.T. 2019 [hereinafter “MLAT”].

<sup>96</sup> Hanneman, *supra* note 93, at 253.; The United States follows a common law system, while Switzerland follows a civil law system.

<sup>97</sup> Gyandoh, *supra* note 32, at 89.

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Legal Assistance in Criminal Matters<sup>98</sup>, which included all elements of European jurisprudence and judicial assistance. Conversely, the United States wanted an agreement that would provide it with the ability to pierce Swiss secrecy laws and obtain information in criminal matters.<sup>99</sup> The Swiss refused to allow the United States access to information protected by its strict secrecy laws and refused to adopt the intrusive discovery proceedings that are prevalent in the United States.<sup>100</sup> As a result of these wishes, it took over five years for the agreement to be signed, resulting in both countries making concessions on the others behalf in order to get the agreement finalized.<sup>101</sup>

The MLAT designates the United States Department of Justice and the Swiss Department of Justice and Policy as the central authorities for requests for assistance between Switzerland and the United States.<sup>102</sup> When a Swiss authority seeks information under the MLAT, the Department of Justice examines the treaty and executes the request if it falls within the applicable guidelines.<sup>103</sup> However, upon ratification, the Swiss adopted legislation that granted specific rights of appeal by parties against a United States request.<sup>104</sup> While this does not ultimately exclude the release of this information, it usually provides significant delays in processing time since any individual opposing release of information may appeal to the Swiss Department of Justice and Policy.<sup>105</sup> The authorities require the requests for information to include detailed information about the subject and reasoning to establish that the MLAT governs the request and is applicable.<sup>106</sup>

The MLAT contains an annex with a list of thirty-five offenses that require compulsory measures to grant assistance from one country to another.<sup>107</sup> Some of the listed offenses include murder, kidnapping, larceny, extortion, fraud, arson, and perjury, among other crimes that are commonly enforced in many modern nations.<sup>108</sup> Notably, the list does not include antitrust, securities or tax violations, since, as it is important to note, Switzerland has no laws on point that regulate antitrust, securities, or tax violations.<sup>109</sup> When a request pertains to an act that is considered a crime by both the United States and Switzerland, but is not included in the list, the Swiss Division of Police has the discretion to comply.<sup>110</sup> As such, assistance for a request is not explicitly granted for those cases.<sup>111</sup>

The United States faced obstacles in getting assistance from the Swiss on issues considered a crime only in one country, since cooperation need only occur when the issue at

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<sup>98</sup> European Convention on Mutual Assistance in Criminal Matters, April 20, 1959, 472 U.N.T.S. 185, Europe T.S. No. 30. Switzerland was a party to this convention, while the United States, not being part of Europe, was not.

<sup>99</sup> Hanneman, *supra* note 93, at 254.

<sup>100</sup> *See Id.*

<sup>101</sup> *Id.*

<sup>102</sup> MLAT, *supra* note 95, at art. 8.

<sup>103</sup> Hanneman, *supra* note 93, at 254.

<sup>104</sup> *Id.*

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> *See* MLAT, *supra* note 95, at ch. I, art. 1

<sup>108</sup> *Id.*; Ellen R. Levin, Comment, *The Conflict Between United States Securities Laws on Insider Trading and Swiss Banking Laws*, 7 NW. J. INT'L L. & BUS. 318, 321 (1985).

<sup>109</sup> Hanneman, *supra* note 93, at 255.

<sup>110</sup> *Id.*

<sup>111</sup> *Id.* at 255.

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law is a crime in both signatory countries.<sup>112</sup> This issue of dual criminality is very important, since although one act, tax fraud for instance, may be a crime in the United States it is not a crime in Switzerland and therefore assistance under the MLAT is not guaranteed.<sup>113</sup> While the MLAT created a situation that allowed the United States to get assistance from a foreign country, the dual criminality requirement effectively limited the usefulness of the treaty.<sup>114</sup> The MLAT does explicitly provide for assistance in ascertaining the whereabouts of persons, taking testimony, effecting production or preservation of documents and records for evidence, and service of process so long as the facts in the request are also criminal in Switzerland.<sup>115</sup>

The Swiss agreed to set aside its bank secrecy laws and divulge information based on this dual criminality, which meant that the United States needed to find another way to overcome it and get assistance in matters not considered criminal abroad but are defined as such here at home.<sup>116</sup> The insider trading issue was initially put to rest when the Swiss Banker's Association and some other banks in Switzerland created a private agreement to assist with economic crimes, essentially creating a private remedy to a major shortcoming of the MLAT.<sup>117</sup> Insider trading was not prohibited in Switzerland until July 1, 1988, so the United States was forced to rely on fraud, which was the closest violation in the listed annex of the MLAT.<sup>118</sup> Over the course of the next few years the United States and Switzerland would exchange supplemental letters and Diplomatic Notes refining and modifying the treaty to ensure the greatest amount of cooperation between the two countries.<sup>119</sup> These Diplomatic Notes expanded the scope of the SEC to obtain assistance for matters related to insider trading and ensured that the United States would be able to use evidence obtained pursuant to the agreement in both criminal and civil and administrative proceedings.<sup>120</sup> The cooperation of the Swiss government in assisting the United States in insider trading cases paved the way for other treaties to be ratified expanding the scope of cooperation to cases involving tax fraud and tax evasion.

## Evolution Today

In Switzerland, tax evasion is regarded as the underpayment of taxes that results from a passive neglect to report income.<sup>121</sup> The Swiss have a very efficient tax collection system, collecting the money at the source, which means that tax evasion is near impossible and is therefore not even considered a crime.<sup>122</sup> Conversely, tax fraud is considered a crime, as it involves the active deception of lying to the authorities on the amount or location of assets.<sup>123</sup> On October 2, 1996, after sixteen long years of negotiation, the United States en-

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<sup>112</sup> Gyandoh, *supra* note 32, at 89.

<sup>113</sup> *Id.*

<sup>114</sup> *Id.*

<sup>115</sup> MLAT, *supra* note 95, at ch I, art 1.

<sup>116</sup> Mencken, *supra* note 33, at 482, n. 159.

<sup>117</sup> *Id.* at 482.

<sup>118</sup> Hanneman, *supra* note 93, at 255.

<sup>119</sup> *Id.* at 257.

<sup>120</sup> *Id.* at 257-8.

<sup>121</sup> Michael Arthur Jones, *Swiss Bank Accounts: A Personal Guide to Ownership, Benefits and Use* 39, 55 (1990).

<sup>122</sup> *Id.*

<sup>123</sup> *See Id.*

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tered into a revised tax treaty with Switzerland (“1996 Treaty”).<sup>124</sup> The 1996 Treaty was part of a “comprehensive undertaking” by the United States to update and modernize all of their tax treaties in existence at the time.<sup>125</sup> This agreement took the place of the original tax treaty between the two countries signed in 1951, specifically creating extensive rules to keep up with the current globalization of the world economy.<sup>126</sup>

Like all evolving treaties, continued negotiations and modifications were proposed to the agreement, which led to a January 23rd, 2003 amendment (“2003 Treaty”).<sup>127</sup> The 2003 Treaty sought to strengthen each government’s ability to effectively combat tax fraud by clarifying what constitutes tax fraud with fourteen hypothetical examples of conduct that would be tax fraud as well as a detailed description of factors that constitute “reasonable suspicion” of fraud.<sup>128</sup> The 2003 agreement also amended the 1996 agreement by establishing new guidelines on the proper implementation of information sharing, specifically related to Article 26.<sup>129</sup>

These amendments were done to specifically prohibit and catch tax evasion by creating stronger information sharing guidelines between the two countries.<sup>130</sup> The information-sharing component of the tax treaty is a contentious one for Switzerland, due to the strong bank secrecy laws prevalent in Swiss society.<sup>131</sup> Previous incarnations of tax treaties between the United States and Switzerland contained provisions for information sharing, but generally the U.S. authorities were unhappy with the amount of information shielded from them in the Swiss veil of secrecy.<sup>132</sup> The United States believed that the 1996 agreement would provide for greater information sharing and thus greater effectiveness in combating tax fraud; however, in light of the tragic September 11, 2001 terror attacks, felt it was imperative to increase the exchange of information with Switzerland.<sup>133</sup> Switzerland, due to their bank secrecy laws, has long been notorious as a haven for money laundering and organized crime, and the United States also suspected that terror organizations would be using the same laws to shield their funding.<sup>134</sup> The United States was surprised to learn that the Swiss were very willing to increase information sharing, in an effort to mitigate damage to their reputation for the perceived safe harbor for criminals and money launderers based on the secrecy laws, and representatives from both countries began meeting to discuss possible revisions to the 1996 Treaty beginning on August 6, 2002.<sup>135</sup>

<sup>124</sup> W. Warren Crowds, *U.S., Switzerland Sign Income Tax Treaty*, 13 TAX NOTES INT’L 785 (Feb. 24, 2003).

<sup>125</sup> Beckett G. Cantley, *The New Tax Information Exchange Agreement: A Potent Weapon Against U.S. Tax Fraud?*, 4 Hous. Bus. & Tax L.J. 231, 233 (2004).

<sup>126</sup> *Id.* at 233.

<sup>127</sup> Press Release, U.S. Dept. of the Treas., Office of Public Affairs, Treasury Announces Mutual Agreement with Switzerland Regarding Tax Information Exchange (Jan. 24, 2003), <http://www.ustreas.gov/press/releases/kd3795.htm> [hereinafter Treasury Announces Mutual Agreement with Switzerland].

<sup>128</sup> Cantley, *supra* note 125, at 232.

<sup>129</sup> “The agreement focuses on interpretation of Article 26 of the U.S.-Swiss treaty, dealing with the exchange of information between competent authorities” as well as “paragraph 10. . . which addresses the definition of tax fraud.” James P. Fuller, *Jim Fuller’s U.S. Tax Review*, 29 TAX NOTES INT’L 785 (Feb. 24, 2003).

<sup>130</sup> Cantley, *supra* note 125, at 232.

<sup>131</sup> A more detailed background on Swiss Bank Secrecy can be found in Section II Part A.

<sup>132</sup> Cantley, *supra* note 125, at 236.

<sup>133</sup> *Id.* at 240.

<sup>134</sup> *Id.* at 240; See also John M. Ferguson, *Swiss Bank Account “Secrecy” Today: More Holes Than Cheese*, 12 EMORY INT’L L. REV. 1131 (1998).

<sup>135</sup> See Cantley, *supra* note 125, at 240.

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The American and Swiss authorities entered into six understandings to “effectuate the 2003 Agreement’s purpose of expanding information sharing between the two countries.”<sup>136</sup> The first and second understandings reiterate the willingness to work together to the greatest extent possible and establish that the statute of limitations of the requesting country applies when information is requested.<sup>137</sup> The third states that information can be requested for both civil and criminal matters, creating greater flexibility and expanding the scope of relevant cases.<sup>138</sup> The fourth and fifth understandings laid out examples that determine what constitutes tax fraud and when a country can request information based on suspicions of fraud.<sup>139</sup> The last understanding links the examples to Article 26 of the 2003 Treaty, expounding the purpose of combating and catching tax fraud.<sup>140</sup> The most important aspect of the 2003 Treaty is that it provides a relaxation of Swiss banking secrecy laws with respect to tax fraud committed by United States citizens.<sup>141</sup> Many people predicted that this agreement would have a significant impact on how business was conducted within Switzerland, specifically in banking with respect to United States taxpayers.<sup>142</sup> This enhanced cooperation was extremely significant at the time; since it expanded the scope of information and promoted judicial assistance enabling the U.S. to increase its ability to effectively monitor possible terrorists and their finances along with persons suspected of tax fraud and evasion.<sup>143</sup> It is these previous agreements, which clearly establish methods of information sharing and economic transparency, that need to be called on to effectuate the turnover of account information to the United States authorities, and to assist with cooperation in the future with other nations.

## IRS VS. SWITZERLAND: TAX FRAUD AND VOLUNTARY DISCLOSURE PROGRAMS

### IRS and the UBS Banker Indictments

Each year, the United States loses an estimated \$100 billion in tax revenues as a result of offshore tax abuses including but not limited to tax fraud, tax evasion, and money laundering.<sup>144</sup> Offshore tax havens are believed to hold billions of dollars in assets belonging to foreign citizens hidden from tax authorities by United States taxpayers and other taxpayers in countries outside of these tax havens.<sup>145</sup> Over the past two (2) years a flurry of activity has revealed that financial institutions in these tax havens have been assisting and facilitating international cross border tax evasion and tax fraud.<sup>146</sup>

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<sup>136</sup> *Id.* at 241.

<sup>137</sup> Treasury Announces Mutual Agreement with Switzerland, *supra* note 126.

<sup>138</sup> *Id.*

<sup>139</sup> *Id.*

<sup>140</sup> Cantley, *supra* note 125, at 241.

<sup>141</sup> See Cynthia Shelton, Marnin Michaels, Stephanie Jarrett, & Denis Bedroz, *Switzerland and U.S. Agree to Swap Tax Information*, 14 J. INT’L TAX’N 54 (Apr. 2003).

<sup>142</sup> Cantley, *supra* note 125, at 253.

<sup>143</sup> *Id.*

<sup>144</sup> Feld, *supra* note 16, at 227.

<sup>145</sup> *Id.*

<sup>146</sup> *Id.*, See also John R. Crook, ed., *Contemporary Practice of the United States Relating to International Law: State Jurisdiction and Immunities: Swiss Bank Settles U.S. Tax Charges, Mounting U. Pressure on Swiss bank Secrecy*, 103 AM. J. INT’L L. 338 (2009).

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In May 2008, one of the first international tax scandals involving UBS began, when authorities in the United States arrested Bradley Birkenfeld, an American citizen and former banker at UBS, AG.<sup>147</sup> The charges stemmed from an alleged conspiracy with a wealthy real estate developer, Igor Olenicoff, to defraud the IRS of \$7.2 million in taxes owed on \$200 million of assets hidden offshore in several places, including Switzerland.<sup>148</sup> Birkenfeld chose to plead guilty and admitted that between 2001 and 2006, while director of a private banking division of UBS, he routinely crossed international borders to the United States as well as had contacts in the United States that assisted in the concealment of the ownership of assets held offshore and instructed clients in how to avoid paying taxes on such accounts.<sup>149</sup> The information provided by Birkenfeld led authorities to determine that his services to American clients violated a 2001 agreement that UBS entered into with the IRS and United States.<sup>150</sup> According to evidence, managers and bankers at the firm assisted these U.S. clients in concealing their ownership interests by creating nominee and sham entities, as well as advising clients to place cash and valuables in Swiss safety deposit boxes, to buy jewelry and other high priced items while overseas using their Swiss funds, and to misrepresent receipt of funds as loans from UBS.<sup>151</sup> These employees helped their clients file false U.S. income tax returns that omitted income earned from the secret funds and misrepresented net worth and account totals.<sup>152</sup> The prosecution of Birkenfeld was made possible by the information gained from the investigation by authorities into Martin Liechli, a senior UBS banking official who worked in the same department as Birkenfeld, as well as Igor Olenicoff as a result of his guilty plea in 2007 for one count of filing a false tax return resulting in the payment of six years of back taxes and interest totaling in excess of \$52 million.<sup>153</sup>

In November 2008, another scandal involving UBS erupted when a United States federal grand jury in the Southern District of Florida indicted Raoul Weil, chairman and CEO of UBS's Global Wealth Management & Business Banking Division, on charges stemming from a conspiracy to hide thousands of accounts from the IRS.<sup>154</sup> Similar to Birkenfeld, Weil was charged with conspiring to defraud the IRS by concealing the identities of UBS's United States clients who willfully evaded their tax obligations.<sup>155</sup> It is clear that the information provided by Olenicoff led to the initial indictment of Birkenfeld, who in turn provided the information that led to Weil.<sup>156</sup> Remarkably, the information provided by Birkenfeld also enabled the Department of Justice to obtain an order from the United States District Court for the Southern District of Florida, where the indictments took place, to issue a John Doe summons, pursuant to the Internal Revenue Code §7609(f).<sup>157</sup>

The John Doe summons, as discussed previously, sought information regarding U.S. taxpayers who may be using UBS banking services to evade the proper payment of federal

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<sup>147</sup> Feld, *supra* note 16, at 227.

<sup>148</sup> *Id.* at 230; *See also U.S. v. Birkenfeld*, Dkt. No. 08-CR-60099 (Zloch) (S.D. Fla., 4/10/08).

<sup>149</sup> *See* Feld, *supra* note 16.

<sup>150</sup> *Id.* at 230 n. 7.

<sup>151</sup> *Id.*

<sup>152</sup> *Id.* at 231.

<sup>153</sup> *Id.*

<sup>154</sup> Crook, *supra* note 146, at 338.

<sup>155</sup> *Id.*

<sup>156</sup> Feld, *supra* note 16, at 231.

<sup>157</sup> *Id.*

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income taxes.<sup>158</sup> This is the first time that a John Doe summons had been issued to a non-U.S. bank and is further evidence of the IRS's continued push to collect the millions of dollars in uncollected taxes.<sup>159</sup> The 52,000 accounts inquired about refers back to a December 2004 internal UBS memo approximating that the bank had 52,000 undeclared account relationships with U.S. taxpayers.<sup>160</sup> Undeclared accounts came into existence during the 2001 agreement with the IRS, and are the accounts of U.S. clients that have not come forward and identified themselves as owners.<sup>161</sup> At the time of that memo the value of the accounts exceeded \$14.8 billion, with almost 33,000 of the accounts containing only cash.<sup>162</sup>

As a result of the information learned in the various prosecutions of UBS bankers, as well as the looming John Doe summons lawsuit, the Department of Justice and UBS entered into a Deferred Prosecution Agreement ("DPA"), acknowledging that from 2000 through 2007 certain members of the private banking sector, Birkenfeld and Weil among them, actively assisted and/or facilitated United States taxpayers to conceal and shield their ownership interests in secret Swiss accounts.<sup>163</sup> Further, UBS agreed to pay \$780 million to settle the civil and criminal charges, with \$380 million reflecting disgorgement of profits and the remaining \$400 million reflecting lost tax revenues stemming from actions by UBS employees.<sup>164</sup> Vast amount of records were presented to show the extent of the UBS operation. For example, in 2004, UBS bankers travelled to the United States an estimated 3,800 times to discuss American Swiss bank accounts, as well as other information that UBS employees used encrypted laptops and engaged in counter-surveillance techniques to hide their clients identities.<sup>165</sup>

**Deferred Prosecution Agreement Details and Subsequent Disclosure Program**

As part of the DPA, UBS agreed to provide the United States government with "voluminous and detailed records concerning accounts held directly or through beneficial arrangements with U.S. [taxpayers]." <sup>166</sup> The August 19th agreement involved the hand over of 4,450 accounts involving "tax fraud or the like." <sup>167</sup> Unfortunately, this is where the problem occurred, since Switzerland's Federal Administrative Court ruled that the accord violated Swiss law by defining fraud too broadly.<sup>168</sup> The ruling as it stood would have forced the United States to reopen suit in Miami federal court, where the initial John Doe complaint was filed.<sup>169</sup> Had UBS initially decided to comply with the initial U.S. order for the turnover of the account details, it would have violated Swiss client secrecy law. On the other hand, had

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<sup>158</sup> *Id.*

<sup>159</sup> *Id.*

<sup>160</sup> *Id.*

<sup>161</sup> *Id.* at 230.

<sup>162</sup> *Id.*

<sup>163</sup> Crook, *supra* note 145, at 338.

<sup>164</sup> *Id.*

<sup>165</sup> *Id.* at 339.

<sup>166</sup> Feld, *supra* note 16, at 228.

<sup>167</sup> David Voreacos, *UBS Tax Ruling May Prompt New U.S. Legal Battle*, BUSINESSWEEK, Jan. 25, 2010, <http://www.businessweek.com/news/2010-01-25/ubs-tax-ruling-by-swiss-court-may-prompt-new-u-s-legal-battle.html>.

<sup>168</sup> *Id.*

<sup>169</sup> *Id.*

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the bank decided not to, it would have been at odds with the U.S. legal system, most likely leading to hefty fines and possible sanctions. As a result, this quickly escalated into a diplomatic relations issue between the U.S. and Switzerland. The new U.S.-Swiss treaty puts pressure on Switzerland to process the data within one year, but also aims at encouraging wealthy Americans to come forward voluntarily through the voluntary disclosure plan program.<sup>170</sup>

The August 19th Agreement between the United States and Switzerland was a final settlement agreement acknowledging and effectuating the Deferred Prosecution Agreement and mutually accepting its terms.<sup>171</sup> The Settlement Agreement was an opportunity for both governments to “[choose] accommodation over confrontation, with face-saving measures for both sides.”<sup>172</sup>

According to the Settlement Agreement, in compliance with the standards of Article 26 of the Convention for the Avoidance of Double Taxation, the IRS will deliver a “request for administrative assistance” to the Swiss Federal Tax Administration to gather information on flagged accounts.<sup>173</sup> Pursuant to the agreement, UBS will provide information about account holders with accounts subject to the treaty request, based on an established criterion to the Swiss Federal Tax Administration.<sup>174</sup> With the help of FINMA, the Swiss Federal Office of Justice will oversee UBS’s compliance with the Deferred Prosecution Agreement.<sup>175</sup> Under the Settlement Agreement, UBS must give notice to those U.S. citizens “whose accounts with UBS are subject to a treaty request for information informing them that they should promptly designate an agent in Switzerland.”<sup>176</sup>

The criteria used by the Swiss authorities to identify and investigate which accounts will be reported to the Swiss Federal Tax Administration were originally kept confidential from the public.<sup>177</sup> The criteria, however, was disclosed in late November, essentially giving UBS’s American clients a greater idea of their chances of being reported and allowing them to better determine the risk they face.<sup>178</sup> The criteria released by the IRS indicated that “if the account met two measures: having more than \$992,802 (1 million Swiss francs) at any time from 2001 through 2008, and generating average annual revenue of more than 100,000 Swiss francs over three years.”<sup>179</sup>

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<sup>170</sup> *Id.*

<sup>171</sup> See Deferred Prosecution Agreement at Exhibit C p. 1, *United States v. UBS AG*, No. 09-60033-CR-COHN (S.D. Fla., Feb. 18, 2009) [hereinafter Deferred Prosecution Agreement] (“UBS provides banking, wealth management, asset management and investment banking services. . .”)

<sup>172</sup> David S. Hilzenrath, *Swiss No Longer Shielding Biggest U.S. Tax Dodgers*, Wash. Post, Nov. 18, 2009, at A13, available at <http://www.washingtonpost.com/wpdyn/content/article/2009/11/17/AR2009111701240.html>.

<sup>173</sup> See Settlement Agreement Concerning DOJ, IRS, SEC, and UBS at 2, between U.S. and Switz., Aug. 19, 2009 available at [http://www.ubs.com/1/ShowMedia/index/crossborder/johndoesettlement?contentId=170419&name=UBS\\_IRS\\_agreement.pdf](http://www.ubs.com/1/ShowMedia/index/crossborder/johndoesettlement?contentId=170419&name=UBS_IRS_agreement.pdf) [hereinafter Settlement Agreement]; Convention for the Avoidance of Double Taxation with Respect to Taxes on Income, U.S.-Switz., May 24, 1951, 2 U.S.T. 1751 (ratified Sept. 27, 1951) [hereinafter Double Taxation]; Treaty on Mutual Assistance in Criminal Matters, U.S.-Switz, Dec. 23, 1975, 27 U.S.T. 2019 [hereinafter Mutual Assistance].

<sup>174</sup> Settlement Agreement, *supra* note 173.

<sup>175</sup> *Id.*

<sup>176</sup> *Id.*

<sup>177</sup> *Id.*

<sup>178</sup> Hilzenrath, *supra* note 172.

<sup>179</sup> *Id.*, See also Lynnley Browning, 14,700 Disclosed Offshore Accounts, N.Y. Times, Nov. 17, 2009, <http://www.nytimes.com/2009/11/18/business/global/18irs.html>.



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**Voluntary Disclosure and the Recent Amnesty Program**

Voluntary disclosure is the term given to the willful correction of past mistakes to the IRS before being caught or contacted.<sup>180</sup> The benefit of coming forward on one's own is that the person will not become subject to a criminal investigation by the IRS.<sup>181</sup> On March 26, 2009, the IRS announced a new Amnesty program allowing for specialty voluntary disclosures relating to accounts held in offshore Swiss bank accounts.<sup>182</sup> The program, which was extended into October due to "receiving repeated requests from tax practitioners and attorneys around the country following an influx of taxpayer requests," imposes much harsher civil and criminal penalties on tax violators.<sup>183</sup> IRS officials decided to extend this deadline after receiving repeated requests from tax practitioners and attorneys around the country following an influx of taxpayer requests. In one week, four hundred applicants sought Foreign Bank Account Reporting ("FBAR") forms, more than four times the number requested in all of last year.<sup>184</sup> Only United States citizens or residents, or visitors who conduct business aside from managing personal investments need to file FBARs.<sup>185</sup> Additionally, the IRS retains the burden of proof for establishing that a violation of the FBAR was willful.<sup>186</sup>

According to estimates by the IRS, a Swiss account holder who voluntarily comes forward with \$1 million account, earning \$50,000 in unreported income annually from 2003 through 2008 might result in taxes and penalties that total \$386,000.<sup>187</sup> Conversely, those that take the risk of not coming clean and are discovered after the deadline might result in \$2.3 million in taxes and penalties along with the possibility of criminal sanctions and prosecution resulting in more fines and potential jail time.<sup>188</sup> So far, the IRS has reported that more than 14,700 Americans have turned themselves in under the voluntary disclosure program.<sup>189</sup> The IRS has indicated that UBS's duty to hand over the 4,450 account names is not contingent on this program's success and that UBS must still comply with the terms of the agreement.<sup>190</sup> Similarly, while the voluntary disclosure of 10,000 accounts would trigger the withdrawal of the John Doe Summons, these 10,000 UBS clients coming forward would "have nothing to do with the obligation that the Swiss have taken to the U.S. government to produce 4,450 account names."<sup>191</sup>

The implementation of such programs is a great strategy for the IRS to encourage tax evaders to come forward and pay back taxes, and it also creates a scenario where the IRS can gather information to help catch other violators.

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<sup>180</sup> Hilzenrath, *supra* note 172, at 242.

<sup>181</sup> *Id.*

<sup>182</sup> IRS Extends Deadline for Disclosing Hidden Offshore Accounts, <http://www.irs.gov/newsroom/article/0,,id=213463,00.html>.

<sup>183</sup> *Id.*

<sup>184</sup> Ashlea Ebeling, *Clock is Ticking For Secret Offshore Account Holders*, BUSINESSWEEK, Sept. 15, 2009, available at <http://www.forbes.com/2009/09/15/offshore-disclosure-irs-deadline-personal-finance-irs.html>.

<sup>185</sup> Feld, *supra* note 16, at 232.

<sup>186</sup> *Id.* at 233.

<sup>187</sup> Ebeling, *supra* note 184.

<sup>188</sup> *Id.*

<sup>189</sup> Browning, *supra* note 179.

<sup>190</sup> *Id.*

<sup>191</sup> *Id.*

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**CURRENT STATUS: WHAT THE SWISS COURT RULING AND SUBSEQUENT  
PARLIAMENTARY ACCEPTANCE MEANS FOR THE AGREEMENT**

With a settlement in place, and both parties appeased with the number of accounts to be handed over, the Swiss courts decided to throw a wrench into the operation. As part of the agreement, UBS clients named in the 4,450 accounts had the ability to file an appeal, and in January 2010, the courts upheld the first appeal, granting the client the ability to prevent their account data from being handed over to the IRS.<sup>192</sup> The case raised doubts about the future of the settlement, since the courts ruled that “an agreement on double taxation with the United States only allows for data to be disclosed in cases of ‘fraud of the like,’” meaning that many of the accounts sought by the IRS may not be permitted.<sup>193</sup> Faced with the potential loss of its license in the United States, UBS was greeted with even more bad news when the Justice Minister forewarned that the failure of talks with the United States might result in the collapse of the bank.<sup>194</sup> Shares of UBS fell to a half-year low, worrying many banking officials who continue to see high wealth clients pull their money out of UBS accounts.<sup>195</sup>

Under the terms of the August deal, UBS could avoid any sanctions and escape the current deadlock if at least 10,000 U.S. clients with undeclared accounts come forward.<sup>196</sup> To this point however, the IRS has declined to say how many of the estimated 15,000 taxpayers that took advantage of the voluntary disclosure program are in fact UBS customers.<sup>197</sup> Connecticut for instance, has come forward and claimed that 148 state residents have come forward and declared accounts at UBS used to avoid taxes.<sup>198</sup> UBS said that it does not believe that the IRS has received the requisite 10,000 clients, meaning that other political channels needed to be utilized to salvage the settlement.<sup>199</sup> The Swiss government became increasingly interested in pushing the court system to overrule their decision and enforce the agreement since it is in the best interests of their economy and the health of their banking system.

In June 2010, Swiss Parliament approved the UBS tax treaty with the IRS, effectuating the end of the legal battle surrounding the handover of the client data.<sup>200</sup> The approval came after a majority vote in both chambers of Parliament after weeks of negotiations where both the upper and lower house dropped a demand to have the treaty go to a national referendum.<sup>201</sup> If the treaty had gone to a referendum, then UBS would have definitely missed the established deadline in the settlement forcing the hand of the United States authorities, but the approval of Parliament created a situation where the bank was confident it could meet its

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<sup>192</sup> Jason Rhodes and Kim Dixon, *UBS Client Wins Appeal Against U.S. Data Handover*, REUTERS, Jan. 22, 2010, <http://www.reuters.com/article/idUSTRE60L3VQ20100122>.

<sup>193</sup> *Id.*

<sup>194</sup> Lisa Jucca, *UBS falls after Swiss comments on U.S. tax row*, REUTERS, Feb. 1, 2010, <http://www.reuters.com/article/idUSTRE6101D420100201>.

<sup>195</sup> *Id.*

<sup>196</sup> *Id.*

<sup>197</sup> *Id.*

<sup>198</sup> Carlyn Kolker, *Connecticut Says 148 Taxpayers Disclosed UBS Accounts*, BUSINESSWEEK, Feb. 8, 2010, <http://www.businessweek.com/news/2010-02-08/blumenthal-says-148-taxpayers-disclosed-ubs-accounts-update1-.html>.

<sup>199</sup> Katharina Bart, *UBS: Don't Believe US IRS Has Date on 10,000 Clients*, WALL ST. J., Feb. 9, 2010, <http://online.wsj.com/article/BT-CO-20100209-705714.html>.

<sup>200</sup> Wille, *supra* note 28.

<sup>201</sup> *Id.*

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obligations.<sup>202</sup> It was clear that in today's era of international business and global transactions that it was in the best interest for both the Swiss and the Americans to come to an agreement and find away to proliferate cooperation between countries to better effectuate a secure transparent banking system that provides accountability and more reliable tax reporting.

## CONCLUSION

The fate of Swiss banking secrecy still hangs in the balance, even as the United States and Switzerland seem to be moving away from a deadlock about their tax settlement. The United States authorities maintained their unwillingness to renegotiate the settlement,<sup>203</sup> but both sides knew it was in the best interest of both countries to rectify the problem and foster a stronger and more stable economic environment. UBS, as one of the largest banks in the world, needs to play an important role in the economic revitalization of the world economy. The warnings that the bank would collapse were a serious indication about the importance of their American business and the Swiss authorities made finding a way to get the settlement ratified by Parliament a top priority.

The approval by Parliament of the double taxation agreement, making it a treaty, trumps the ruling by the high court limiting the assistance of the Swiss to only 250 of the 4,450 accounts in question. As other countries begin to pursue secret account holders withholding their taxes, UBS and other Swiss banks will continue to face major scrutiny.<sup>204</sup> It is extremely important that UBS and the United States authorities satisfy the terms of their settlement and work toward rebuilding a shaken confidence in global banking.

As the financial world waits to see the eventual outcome of this settlement, other countries, such as Germany, have begun their own fight against bank secrecy in Switzerland.<sup>205</sup> Many other countries have made strides in effectuating double taxation and information sharing agreements with Switzerland, signaling the perceived end of bank secrecy.<sup>206</sup> While the element of secrecy might not exist in Switzerland as it once did, Swiss banks are using the same techniques and shifting their high net wealth operations to Singapore and Hong Kong.<sup>207</sup> The struggle to effectuate and cultivate a culture of information sharing in Europe and the results that are currently being seen will aid in the eventual struggle to seek out and find hidden accounts in Asian markets.

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<sup>202</sup> *Id.*

<sup>203</sup> Jason Rhodes, *U.S. Won't Renegotiate UBS Tax Deal: Report*, REUTERS, Feb. 7, 2010, <http://www.reuters.com/article/idUSTRE61614120100207>.

<sup>204</sup> Doug Alexander, *UBS May Be Sued by Canada on Offshore Account*, *Globe Reports*, BLOOMBERG, Sept. 25, 2009, [http://www.bloomberg.com/apps/news?pid=20670001&sid=ARTnEfy\\_qbww](http://www.bloomberg.com/apps/news?pid=20670001&sid=ARTnEfy_qbww).

<sup>205</sup> Warren Giles, *Swiss Tax Treaty With Germany May Finish Bank Secrecy in Europe*, BLOOMBERG, Oct. 1, 2010, <http://www.bloomberg.com/news/2010-09-30/swiss-tax-treaty-with-germany-may-finish-bank-secrecy-in-europe.html>.

<sup>206</sup> *Id.* ("The Swiss parliament has already approved 10 such tax agreements, including those with the U.S., France and the U.K., while the government initialed of signed accords with 18 other countries.").

<sup>207</sup> *Swiss Banking Secrecy Shifts to Singapore, Hong Kong*, *ECONOMIC TIMES*, Sept. 24, 2010, <http://economictimes.indiatimes.com/news/international-business/Swiss-banking-secrecy-shifts-to-Singapore-Hong-Kong/articleshow/6616645.cms> ("From UBS, which operates a training centre in Singapore, to smaller private banks like Julius Baer, Swiss banks and those with Swiss-based operations are working to expand in the region.").

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A strong global economy is imperative to a strong domestic economy in today's society, and as such, the UBS tax deal will be looked upon as an example of strengthening and building stronger relationships between nations. The cooperation of tax authorities and multinational banks will only lead to a more efficient system for collecting and maintaining taxes for citizens around the world. While the future of Swiss banking secrecy is murky at best, there are plenty of ways to salvage a practice steeped in history and intrigue. An evolution of banking practices can help the Swiss banking industry establish itself as the most efficient and stable in the world, and in the face of the recent global debt crisis, cooperation with other nations will only assist in building confidence in the banking system and the various services it provides.<sup>208</sup> Swiss banking will never have the same clandestine feel as it did in the 1980s and 1990s, but with improved transparency between government agencies and continued evolution of information sharing agreements for evidence and service of process, the Swiss may be able maintain the semblance of secrecy and reliability that initially drew people to the safe protections of their banks.

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<sup>208</sup> Richard H. Schweizer, *Switzerland Is The Only Haven For Americans Trying To Avoid Debt Chaos*, BUSINESSINSIDER, Oct. 1, 2010, <http://www.businessinsider.com/swiss-bank-protection-us-dollar-2010-10>. ("Countries with low government debt and low primary deficits may be a place to hide from the current turmoil and Switzerland . . . may be a decent haven after all.").