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I. INTRODUCTION

On August 1, 2006, the U.S. 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 culminated in the subcommittee's investigation into tax haven abuses, providing the most detailed look at high-level tax schemes to date.[2] The report revealed that an alarming number of rich Americans are using offshore accounts to evade taxes, and suggested that law enforcement would be unable to control the growing misconduct.[3] Senator Carl Levin, the PSI Chairman, stated, "The universe of offshore tax cheating has become so large that no one, not even the United States government, could go after it all."[4] This investigation marked the first salvo of the federal government's new attack on offshore tax evasion. The principal focus of this attack appears to be unreported offshore bank accounts.[5] Due to its stringent banking laws and its stronghold on foreign money, Switzerland has historically been considered a bastion for banking secrecy, and a favorite place for U.S. residents to hold such accounts.[6] While there is an existing tax information exchange agreement (TIEA) between the United States and

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1 *See generally* PERMANENT SUBCOMM. ON INVESTIGATIONS, COMM. ON HOMELAND SEC. AND GOV'T AFFAIRS, 109TH CONG., TAX HAVEN ABUSES: THE ENABLERS, THE TOOLS AND SECRECY (2006) [hereinafter TAX HAVEN ABUSES] (released in conjunction with the Permanent Subcomm. on Investigations Aug. 1, 2006 Hearing).

2 David Cay Johnston, *Tax Cheats Called Out of Control*, N.Y. TIMES, Aug. 1, 2006, at B2.

3 *See id.*

4 *Id.*

5 *See generally* TAX HAVEN ABUSES, *supra* note 1 (Many of the findings and recommendations focus on offshore activity, and the first section following the findings and recommendation is a report detailing "the Offshore Industry.").

6 *See, e.g.*, 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 ("Swiss banks...hold an estimated $2 trillion dollars in foreign money, and financial services add about 12% to the country's economic output. According to the Boston Consulting Group, these holdings total one-fourth of the world's foreign-owned assets.").

Switzerland—last significantly revised in 2003—a judicial battle has evolved over the United States' new efforts to focus its attack on Swiss accounts and obtaining account-holder information from UBS.[7]

The policy goals of the United States are clearly legitimate, but the means of obtaining the information are overreaching given how vigorously the United States guards its own legal exceptionalism. The Swiss are understandably concerned that the United States is not respecting Swiss domestic law. After all, the United States has personal jurisdiction over its own citizens; therefore, there should be better ways of obtaining this information while simultaneously respecting the domestic laws of another sovereign country, especially a friendly country such as Switzerland. This paper will dissect the intricacies and arguments surrounding the U.S. attack on offshore banking; discuss the U.S.-Swiss TIEA; and take a detailed look into the development, policy implications, and consequences of *U.S. v. UBS AG*.[8]

II. IRS OFFSHORE ATTACK

Especially in this time of economic turmoil, the government is concerned about billions of dollars of lost revenue from unpaid taxes.[9] Senator Carl Levin, as Chairman of the PSI, is the U.S. senator leading the investigations into offshore tax evasion. Not only do the offshore schemes targeted by Senator Levin and the PSI drastically reduce the U.S. government's ability to monitor its citizens' financial situations, but they also significantly increase the gap between taxes owed and taxes paid.[10] The U.S. government has a strong interest in uncovering these schemes. According to Senator Levin, such schemes must be shut down because they undermine the integrity of the American tax system and render the government unable to "pay for critical needs, avoid going deeper into debt, and protect honest taxpayers."[11] Specifically, these tax schemes "[rob] the [U.S.] Treasury of more than $100 billion each year,

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[7] *See* STAFF OF THE JOINT COMM. ON TAXATION, 111TH CONG., JCX-23-09, TAX COMPLIANCE AND ENFORCEMENT ISSUES WITH RESPECT TO OFFSHORE ACCOUNTS AND ENTITIES, at 31-33 (2009) [hereinafter TAX COMPLIANCE AND ENFORCEMENT ISSUES] (scheduled for a Public Hearing before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means on Mar. 31, 2009).

[8] U.S. v. UBS AG, No. 09-20423-CIV-GOLD/MCALILEY (S.D. Fla. July 9, 2009), *dismissed per stipulation*, Agreement Between the U.S. & Swiss Confederation, 2009 WL 2524345 (2009).

[9] *See generally id.* (detailing the government's effort to collect U.S.-source income tax relating to offshore accounts).

[10] *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS: Testimony Before the S. Comm. on Fin.*, 111th Cong. 1 (2009) (statement of Michael Brostek, Dir., Strategic Issues Team).

[11] Sen. Carl Levin, *Statement Introducing the Stop Tax Haven Abuse Act, Part I*, TAX ANALYSTS, Feb. 12, 2007, at 1-2 [hereinafter Levin, *Statement*].

and [shift] the tax burden from high income persons and companies onto the backs of middle income families."[12] 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."[13] These laws permit offshore service providers to engage in procedures that allow them to go to "extraordinary lengths to protect their U.S. clients' identities and financial information."[14] 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 the information they need to enforce U.S. tax laws."[15]

At the G-20 summit in London on April 20, 2009, the United States, the United Kingdom, France, and Germany each sought to pressure financial centers worldwide to modify their banking secrecy laws.[16] While each country had its own reasons for exerting such pressure, this part of the paper focuses on the United States' reasons for seeking to modify international banking secrecy laws. These reasons include the discovery of a scheme involving two billionaire brothers that gave credence to the concerns outlined in the 2006 PSI investigation,[17] the government's desire to rein in tax evaders through the Voluntary Disclosure Initiative,[18] the inadequacy of international tax examinations and the Qualified Intermediary (QI) program to enforce tax compliance,[19] and the existence of non-filers associated with foreign bank accounts.[20]

A. The Case of the Billionaire Brothers

In September 2006, Forbes ranked Samuel Wyly on its list of richest Americans.[21] Forbes estimated Sam's net worth to be around $1.1 billion, earned mostly from investments.[22] Sam's older brother Charles has a

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[12] *See id.* at 1.
[13] *Id.* at 5.
[14] *Id.*
[15] *Id.*
[16] Diana Erbsen et al., *IRS Issues Voluntary Disclosure Guidance for Unreported Offshore Accounts and Entities*, TAX UPDATE, Mar. 31, 2009, at 1, *available at* http://www.dlapiper.com/irs-issues-new-voluntary-disclosure-guidance-for-unreported-offshore-accounts-and-entities/.
[17] *See* TAX HAVEN ABUSES, *supra* note 1, at 113-360.
[18] Kristen A. Parillo, *IRS Streamlines Offshore Disclosure Process*, TAX ANALYSTS, July 30, 2009 (Doc. 2009-17268) [hereinafter *IRS Streamlines Offshore Disclosure Process*].
[19] *See* Brostek, *supra* note 10, at 7-11.
[20] *See* IRS, *FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR)—Filing Requirements*, http://www.irs.gov/businesses/small/article/0,,id=210244,00.html (last updated Apr. 28, 2010).
[21] *Special Report: The 400 Richest Americans*, FORBES (Sept. 21, 2006), http://www.forbes.com/lists/2006/54/biz_06rich400_The-400-Richest-Americans_Rank_15.html.
[22] *Id.*

personal portfolio almost equal to Sam's.[23] The Wyly brothers, who are Texan entrepreneurs, are notorious not only for their eye-popping wealth, but also for the multiple tax evasion investigations they have incurred by separate federal and state agencies.[24]

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.[25] However, this charge was small compared to the investigation revealed in the previously mentioned 2006 PSI report.[26] According to that investigation, early in the 1990s the brothers set about establishing fifty-eight offshore trusts and corporations, which they operated for more than thirteen years without alerting U.S. authorities.[27] The brothers set up the trusts in the name of individual family members, and located them in the Isle of Man—a noted tax haven.[28] To move funds abroad, the brothers transferred over $190 million in stock option compensation from publicly traded U.S. companies to offshore corporations, Michael's being only one of many.[29] 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 their investments], the offshore corporations provided them with private annuities which would not begin to make payments to them until years later."[30] Meanwhile, the brothers were having their options cashed in and the proceeds invested without disclosing the transactions to the SEC.[31]

The PSI traced "more than $700 million in [untaxed] stock option proceeds that the brothers invested in 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

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[23] Katie Fairbank & Sudeep Reddy, *Billionaire Brothers Under a Microscope: They're Known for Gifts to Charities, Politics, but Tax Shelters Scrutinized*, THE DALLAS MORNING NEWS, Aug. 26, 2006, *available at* http://www.tmcnet.com/usubmit/2006/08/27/1832755.htm.

[24] Press Release, Democratic Nat'l Comm., Another Bad Batch of Bush Money (June 6, 2005) (available from ProQuest); Brendan M. Case, *Selling Secret Accounts Draws Scrutiny: Senate Report Blasts Dallas Firm for Offshore Services for the Masses*, THE DALLAS MORNING NEWS, Aug. 13, 2006, (available from ProQuest) (stating that the brothers are being investigated by the SEC, a grand jury in Dallas, and a grand jury in New York).

[25] *See* Democratic Nat'l Comm., *supra* note 24.

[26] *See* TAX HAVEN ABUSES, *supra* note 1, at 113-360 (providing extensive background and details of the Wyly case).

[27] *See* Levin, *Statement*, *supra* note 11, at 3.

[28] *See* Democratic Nat'l Comm., *supra* note 24.

[29] *See* Levin, *Statement*, *supra* note 11, at 3.

[30] *Id.*

[31] *Id.*

[32] *Id.*; *see* TAX HAVEN ABUSES, *supra* note 1, at 118.

offshore trusts to allocate $600 million of 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 of 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] "[T]he brothers and their representatives communicated [their] directives to a so-called trust protector who then relayed these directions to the offshore trustees."[37] These trustees never rejected a Wyly order nor initiated any action without the brothers' approval.[38] Senator Levin explained that it was simple for these billionaire brothers to take advantage of a practice dubbed the "Foreign Trust Loophole."[39] The Wylys' offshore trustees had "discretion" to name beneficiaries of the offshore trusts, which were, for paperwork purposes, companies in the trustees' countries.[40] However, the application of this discretion had already been determined, since the trustees had been informed that trust assets were to go to the Wyly children upon the death of their respective fathers.[41] The trustees also knew they could be replaced if they failed to comply with the Wylys' instructions.[42] Additionally, in accordance with the trust protector's orders, the trustees authorized millions of dollars in trust income to be invested in Wyly businesses and used to purchase personal property for the Wyly family.[43]

[33] Kelly Fraser & Leah Graboski, *"U" Donor Investigated for Tax-Evasion Report*, THE MICHIGAN DAILY, Aug. 6, 2006, *available at* http://www.michigandaily.com/content/u-donor-investigated-tax-evasion-report; *see* Levin, *Statement*, *supra* note 11, at 3.
[34] *See* Levin, *Statement*, *supra* note 11, at 3.
[35] *Id.*
[36] *See id.* at 3-4.
[37] *See id.* at 6.
[38] *See id.*
[39] *Id.* at 15; Will Deener, *Probe of Offshore Investments Expanding,* THE DALLAS MORNING NEWS, June 4, 2005 (available from ProQuest) (describing the Wylys' tax evasion scheme thus: "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 the options are transferred, the trust exercises the stock options and sells the stock in the 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.").
[40] *See* Levin, *Statement*, *supra* note 11, at 15.
[41] *Id.*
[42] *Id.*
[43] *Id.*

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

B. Non-Filers with Foreign Bank Accounts

Every United States person who has one or more foreign bank account(s) that at any point during the year reaches an aggregate balance of over $10,000 is obligated to file a report with the United States Department of Treasury listing all foreign accounts.[46] Under this regulation, a "United States person" is any of the following: (1) a citizen or resident of the United States; (2) a domestic partnership; (3) a domestic corporation; or (4) a domestic estate or trust.[47] "Financial accounts" include bank accounts, brokerage accounts, mutual funds, securities, derivatives, financial instrument accounts, and debit and prepaid credit cards maintained with a financial institution.[48] U.S. investors in offshore hedge funds and private equity funds are also required to file a Report of Foreign Bank and Financial Accounts (FBAR).[49]

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[44] *See* Johnston, *supra* note 2, at B2.

[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.").

[46] Memorandum from IRS on Report on Foreign Bank and Financial Accounts (June 30, 2009), http://www.irs.gov/businesses/small/article/0,,id=148849,00.html.

[47] *Id.*; *Recent Developments Encourage Voluntary Correction of Foreign Financial Bank Account Reporting Violations*, MCDERMOTT NEWSL. (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 [hereinafter MCDERMOTT NEWSL.] (stating that "[a] United States person has a 'financial interest' in each account for which such 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-United States persons). The instructions [on the FBAR form] now provide that the owner of record or holder of legal title includes a corporation in which the United States person owns directly or indirectly more than 50 percent of the total value or more than 50 percent of the voting power for all shares of stock, and a partnership in which the United States person owns an interest in more than 50 percent of the profits or more than 50 percent of the capital of the partnership.").

[48] IRS, Form TD 90-22.1 at 6, *available at* http://www.irs.gov/pub/irs-pdf/f90221.pdf (stating this includes savings, demand, checking, and deposit accounts, or any other account maintained with a financial institution); *see* MCDERMOTT NEWSL., *supra* note 47 ("[I]ndividual bonds, notes or stock certificates and an unsecured loan to a foreign trade or business that is not a financial institution, are not financial accounts…[C]orrespondent or 'nostro' accounts (international interbank transfer accounts) maintained by banks that are used solely for the purpose of bank-to-bank settlement are also not considered financial account for these purposes.").

[49] Kristen A. Parillo, *Hedge Fund Investors Must File FBAR, IRS Confirms*, TAX ANALYSTS, June 29, 2009 (Doc. 2009-14609) at 18 (stating there has been confusion over the rules in recent years).

The failure to file an FBAR or to disclose foreign accounts can lead to significant civil and criminal penalties.[50] Civilly, a person can be fined up to $10,000 for non-willful noncompliance and up to the greater of $100,000 or fifty percent of the amount of the underlying account's balance at the time of the violation if the noncompliance is determined to be willful.[51] A person can be criminally prosecuted and fined either up to $250,000 and imprisoned for five years or, if the violation occurred in tandem with any other U.S. law violation, the individual will be fined $500,000 and imprisoned for ten years.[52] The penalties are also applicable if a person supplies false information or omits information.[53]

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.[54] 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 $5,000 to $15,000, depending on the particular amounts.[55] If a "willful" non-filer meets the same threshold conditions, penalties can range from five percent to fifty percent of the maximum balance in the particular account for the year in question.[56] The Voluntary Disclosure Initiative, mentioned above, was an additional IRS step aimed at bringing non-filers into the fold by offering reduced penalties.[57]

C. Other IRS Offshore Enforcement Issues

[50] Client Alerts, Cooley LLP, *Foreign Account Disclosure: Possible June 30 Filing Obligation for Certain Funds and LPs*, TAX UPDATE, June 2009, *available at* http://www.cooley.com/62717 [hereinafter *Foreign Account Disclosure*].

[51] *Workbook on the Report of Foreign Bank and Financial Accounts (FBAR)*, http://www.irs.gov/businesses/small/article/0,,id=159757,00.html#penalties (last updated Mar. 30, 2010).

[52] *Id.*

[53] *See Foreign Account Disclosure*, *supra* note 50, at 2.

[54] Philip T. Pasmanik & Neil J. Sullivan, *Report of Foreign Bank and Financial Accounts: Significant Revisions and Severe Penalties*, THE TAX ADVISER, July 2009, at 462 (on file with American Institute of Certified Public Accountants); *see* MCDERMOTT NEWSL., *supra* note 47 (explaining that the new guidelines have given clarity to those considering voluntary disclosure on how to proceed).

[55] *See* MCDERMOTT NEWSL., *supra* note 47 ("The threshold conditions are as follows: "[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 illegal source nor used to further a criminal purpose; [3] The person cooperated during the examination…; and [4] The IRS did not sustain a civil fraud penalty against the person for an underpayment of taxes for the year in question due to the failure to report income related to any amount in the foreign account.").

[56] *Id.*

[57] *See id.*

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.[58] Abusive and evasive offshore tax schemes present challenges related to the oversight of foreign accounts, the enforcement of myriad tax laws, 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 the difficulties obtaining information from third-party financial institutions.[59] This Section specifically addresses IRS time constraints, the Qualified Intermediary (QI) program, and the pending Stop Tax Haven Abuse Act in Congress.

A major issue for agency enforcement policy is the time constraint the IRS faces when conducting examinations that include offshore tax issues.[60] By and large, offshore examinations take much longer than do their domestic counterparts.[61] A 2009 U.S. Government Accountability Office report shows that offshore examinations take, on average, five hundred more calendar days to develop and examine than do domestic audits.[62] Reasons behind this lag include, but are not limited to, technical complexity and difficulty accessing information from foreign sources.[63] Despite the extra time required, 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.[64] This often leads to the IRS prematurely ending an offshore examination or choosing not to open one at all, despite evidence of likely noncompliance.[65] IRS Commissioner Shulman testified that it would be helpful for Congress to extend the statute of limitations from three years to six years to assess offshore tax liability.[66] However, Congress has yet to codify this request.[67]

Another problem for the IRS is the Qualified Intermediary (QI) program.[68] While it is an effective program where properly utilized, it is

[58] Brostek, *supra* note 10, at 7.
[59] *Id.*
[60] *Id.* at 8.
[61] *See id.*
[62] *Id.*
[63] *Id.*
[64] *Id.*
[65] *Id.*
[66] *Id.* at 9.
[67] *See id.*
[68] *See id.* at 10; *see also* TAX COMPLIANCE AND ENFORCEMENT ISSUES, *supra* note 7, at 22-25 ("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

insufficient to address all instances of offshore tax evasion.[69] Michael Brostek explains, "Under the QI program, foreign financial institutions voluntarily report to the IRS income earned and 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."[70] Unfortunately, significant gaps exist in the information available to the IRS about offshore account owners.[71] Additionally, a low percentage of U.S. source income sent offshore flows through QIs.[72] In 2003, for example, only about twelve percent of $293 billion in U.S. income flowed through QIs.[73] 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 at face value account owners' self-certification of their identities.[74] The reliance on self-certification leads to a greater potential for improper withholding because of misinformation or fraud.[75]

Due to the extensive number of problems facing the IRS in offshore tax enforcement, Commissioner Shulman has conceded that "[t]here is general agreement in the tax administration community that there is no 'silver bullet' or one strategy that will alone solve the problems of offshore tax avoidance."[76] However, despite this grim reality, the IRS has pursued a number of avenues to get a handle on the situation.[77] The Senate and the House of Representatives have introduced identical bills, each entitled the Stop Tax Haven Abuse Act.[78] These bills were in the

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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.").

[69] Brostek, *supra* note 10, at para. 1.

[70] *Id.* at 10.

[71] *See id.*

[72] *Id.*

[73] *Id.*

[74] *Id.*

[75] *Id.* (stating that the UBS cases—discussed later in this paper—demonstrate how QIs are insufficient to eliminate offshore tax evasion).

[76] *Id.* at 11.

[77] *See id.*

[78] *See generally* Press Release, Sen. Carl Levin, Summary of the Stop Tax Haven Abuse Act (Mar. 2, 2009), http://levin.senate.gov/newsroom/release.cfm?id=308949 (Senate Bill 506 and House Bill 1265, proposing to, *inter alia*, (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) authorize 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 United States, to be treated as domestic corporations and

committee stage of both Congressional Houses, which is the first step in the legislative process, but as of February 2011 had not become law.[79] 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."[80] The IRS is also "exploring how to improve information reporting and sharing."[81] Because QI allows important insight into the activities of U.S. taxpayers at foreign banks and financial institutions, the IRS is continuously looking at how to improve the QI program.[82]

D. The Voluntary Disclosure Initiative

The IRS has long had a voluntary disclosure practice, under which taxpayers may voluntarily disclose non-compliance.[83] Although this practice creates no substantive rights for the taxpayer, it is one factor for the IRS to consider in determining whether to criminally prosecute the taxpayer.[84] On March 23, 2009, the IRS, in line with the government's growing resistance to continued tax evasion as highlighted by the case of the billionaire brothers,[85] announced a new, temporary initiative specifically targeted at offshore accounts that they hoped would encourage tax evaders to return to legal activity.[86] This new program, called the Voluntary Disclosure Initiative, significantly lowered the penalties for unpaid taxes for those individuals or companies that

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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).

[79] Jennie Cherry & Rashad Wareh, *IRS Increases Focus on Offshore Tax Matter*, TAX UPDATE (June 4, 2009) (Int'l Law Offices), *available at* http://www.internationallawoffice.com/newsletters/Detail.aspx?g=330dfbdb-d3e7-48da-bf56-d08c1ee10f20; *see* GovTrack, *S. 506 [111th]: Stop Tax Haven Abuse Act*, http://www.govtrack.us/congress/bill.xpd?bill=s111-506 and GovTrack, *H.R. 1265 [111th]: Stop Tax Haven Abuse Act*, http://www.govtrack.us/congress/bill.xpd?bill=h111-1265 (stating that these bills never became law because the sessions expired before they were enacted).

[80] *Tax Issues Related to Ponzi Schemes and an Update on Offshore Tax Evasion Legislation: Hearing Before the S. Fin. Comm.*, 111th Cong. 2 (2009) (statement of Doug Shulman, IRS Comm'r).

[81] *See id.* at 6.

[82] *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).

[83] *See* Revised IRS Voluntary Disclosure Practice, Tax Crimes General, IRM 9.5.11.9 (June 26, 2009), *available at* http://www.irs.gov/newsroom/article/0,,id=104361,00.html [hereinafter IRM].

[84] *Id.*

[85] *See supra* Part II.A.

[86] *IRS Streamlines Offshore Disclosure Process*, *supra* note 18.

voluntarily disclosed their offshore accounts.[87] The program took effect on March 23, 2009, and initially terminated on September 23, 2009.[88] It 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 Manual, and paid—or arranged to pay—the taxes due.[89]

The IRS's intent was two-fold.[90] First, the IRS hoped to incentivize noncompliant, eligible taxpayers to become compliant by setting forth a favorable penalty framework.[91] Second, the government hoped to recoup the lost tax revenue.[92] The policy goals behind the initiative included providing predictable and effective rules to deal with the potentially large class of noncompliant U.S. taxpayers using offshore accounts without proper disclosure or tax payments, reducing the difficulty of obtaining information from offshore banking countries, and satisfying requests for certainty from tax professionals.[93]

To reach the agency's goals, IRS personnel could now apply a new penalty framework to voluntary disclosure requests of previously unreported offshore entities and accounts.[94] Under the new Voluntary Disclosure Initiative, the IRS would assess taxes and interest for the six years prior the voluntary disclosure.[95] The taxpayers who took advantage of the program were required to go back and file or amend all returns for the applicable period, including filing the FBAR.[96] The IRS would assess penalties, including accuracy or delinquency penalties, on taxes that

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[87] *See id.*
[88] *Id.*
[89] Erbsen et al., *supra* note 16, at 2; IRM, *supra* note 83 (stating: "(3) A voluntary disclosure occurs when the communication is truthful, timely, complete, and when: a. the taxpayer shows a willingness to cooperate (and does in fact cooperate) with the IRS in determining his or her correct tax liability; and b. the taxpayer makes good faith arrangements with the IRS to pay in full, the tax, 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 examination or criminal investigation of the taxpayer, or has notified the taxpayer that it intends to commence such an examination or investigation; b. the IRS has received information from a third party (e.g., informant, other governmental agency, or the media) alerting the IRS to the specific taxpayer's noncompliance; c. the IRS has initiated a civil examination or criminal investigation 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 (e.g., search warrant, grand jury subpoena).").
[90] Erbsen et al., *supra* note 16, at 3.
[91] *Id.*
[92] *Id.*
[93] *See id.* at 2.
[94] *Id.*
[95] *Id.* ("except where an account or an entity was formed or acquired within the six-year look-back period, in which case taxes and interest will be assessed starting with the earliest year in which the account was opened or acquired, or an entity was formed").
[96] *Id.*

should have been reported, unless there was reasonable cause to support the discrepancy.[97] The sole penalty that would apply would be a penalty equal to twenty percent of the foreign account balances in the year in which the balances were at their highest.[98] The penalty could be reduced to five percent in the case of certain inherited accounts.[99]

The temporary program, like the ongoing voluntary disclosure practice, does not guarantee immunity from prosecution, but it is one of the best methods for taxpayers to minimize the likelihood of criminal penalties.[100] For cases involving unreported offshore income in which the taxpayer did not use the Voluntary Disclosure Initiative, the IRS is "instructing [the] agents to fully develop the case pursuing both civil and criminal penalties, including the maximum penalty for the willful failure to file an FBAR report and the fraud penalty."[101]

In conjunction with this program, the IRS posted a form to its website that allowed taxpayers to provide the necessary information to be considered for the Voluntary Disclosure Initiative.[102] 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 regarding what information is required.[103] The implementation of this form appears to have paid off, as the IRS is pleased with the initiative's response.[104] Friedland stated that during the week of July 20, 2009 alone, the IRS received more than four hundred

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[97] *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).

[98] *Id.* at 3.

[99] *Id.* (providing the conditions that must be satisfied to qualify 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)").

[100] *Id.* at 2; IRM, *supra* note 83, at subparagraph (2) (this does not apply to a taxpayer with an illegal income source).

[101] Statement, Douglas Shulman, IRS Comm'r, Conference Call Regarding Voluntary Disclosure Initiative, (Mar. 26, 2009) (transcript on file with the author) (stating: "Those who truly come in voluntarily will pay back taxes, interest, and a significant penalty, but can avoid jail time.").

[102] *IRS Streamlines Offshore Disclosure Process*, *supra* note 18; Memorandum from IRS on 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).

[103] Memorandum from IRS on Offshore Voluntary Disclosures, *supra* note 102.

[104] *See id.*

requests to participate in the program.[105] This number represents more than four times the total number of requests received during 2008 in its entirety.[106]

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

A Tax Information Exchange Agreement (TIEA) is a bilateral agreement between two sovereign countries governing a mutual exchange of information.[107] The goals behind the United States' initiation of its tax information exchange program were to assure the accurate assessment and collection of taxes, to prevent fiscal fraud and tax evasion, and to develop improved sources for tax matters in general.[108]

The United States entered a TIEA with Switzerland—a powerhouse in offshore banking—effective December 19, 1997.[109] Article 26 of The Convention Between the United States and Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (Convention) provided that the authorities of the two countries would exchange tax information as necessary for the "prevention of tax fraud or the like in relation to taxes which are subject …" to the Convention.[110] This exchange of information included both civil and criminal matters.[111] This Section looks at the 2003 changes to the Convention[112] followed by a discussion of the policy behind updating the TIEA.[113]

A. The 2003 Changes

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[105] *Id.*
[106] *Id.*
[107] *See* TAX COMPLIANCE AND ENFORCEMENT ISSUES, *supra* note 7, at 54.
[108] *See id.* at 55.
[109] *See* Client Alert, Baker & McKenzie LLP, *Switzerland and United States Sign Tax Information Exchange Agreement*, (Feb. 2003), *available at* http://www.bakernet.com/NR/rdonlyres/4938F894-564E-45D8-8DD5-07A5E7D5FCDE/29591/SWITZERLANDANDUNITEDSTATESSIGNTAXINFOEXCHAN.pdf [hereinafter *Tax Information Exchange Agreement*].
[110] *Id*. at 1.
[111] *See id.*
[112] Press Release, U.S Dep't of the Treas., Mutual Agreement of January 23, 2003, Regarding the Admin. of Article 26 (Exchange of Information) of the Swiss-U.S. Income Tax Convention of October 2, 1996, (Jan. 23, 2003) *available at* http://www.treasury.gov/press-center/press-releases/Pages/mutual.aspx [hereinafter Mutual Agreement]; *see generally Tax Information Exchange Agreement*, *supra* note 109 (outlining changes to the Convention).
[113] *See Tax Information Exchange Agreement*, *supra* note 109, at 1; *see generally* Press Release, U.S. Dep't of the Treas., Office of Public Affairs, Treasury Announces Mutual Agreement with Switzerland Regarding Tax Information Exchange (Jan. 24, 2009) *available at* http://www.treasury.gov/press-center/press-releases/Pages/kd3795.aspx (including the text of the Mutual Agreement, Letter from Acting Treasury Secretary Kenneth Dam, and Letter from Swiss Fin. Minister Kaspar Villiger).

Controversy surrounded the definition of "tax fraud" almost immediately upon inception of the Convention.[114] Under Swiss law, tax fraud generally occurs only when documents are forged or falsified, or when there is a scheme of lies to deceive tax authorities.[115] The United States has a more liberal view of what tax fraud entails, including things such as the failure to file a tax return or omission of certain income from a return.[116] The changes employed under the 2003 mutual agreement lean toward the more liberal American view.[117]

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.[118] The agreement was intended to clarify what behaviors constituted "tax fraud" by outlining fourteen hypothetical situations where tax fraud is recognized.[119] This list was not meant to be exhaustive and only provides basic guidelines for each country's constituents and financial institutions.[120] The countries also agreed upon six "understandings."[121] The first understanding emphasizes both countries' renewed efforts to work together to the greatest extent possible to support the tax administration of both countries.[122] The second understanding states that when information is requested, the statute of limitation of the requesting party applies.[123] The third understanding allows information to be requested for both criminal and civil penalties.[124] The fourth understanding sets forth three examples, provided for in the original agreement, that establish when a country can request information if it is believed or suspected that there is tax fraud being committed.[125] The fifth understanding stipulates that each country will share information when the other country has a "reasonable suspicion" that certain conduct would constitute fraud.[126] The sixth understanding

[114] *See Tax Information Exchange Agreement*, *supra* note 109, at 1.
[115] *Id.*
[116] *See id.*
[117] *See id.* at 2.
[118] U.S. Dep't of the Treas., *supra* note 113.
[119] *See* Mutual Agreement, *supra* note 112, at 3-10.
[120] *See id.*
[121] *Id.* at 1-2.
[122] *Id.* at 1.
[123] *Id.*
[124] *Id.* at 1-2.
[125] *Id.* at 2; *Tax Information Exchange Agreement*, *supra* note 109, at 1 (these examples include "(a) conduct established to defraud individuals or companies, even though the aim of the behavior may not be to commit tax fraud; (b) conduct that involves destruction or non-production of records, or the failure to prepare or maintain correct and complete records; [and] (c) 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").
[126] Mutual Agreement, *supra* note 112, at 2.

states that these preceding examples will constitute tax fraud under Article 26 of the Convention.[127]

B. Policy Behind Updating the TIEA

TIEAs, entered into mutually, can foster advantageous symbiotic relationships.[128] Many countries, including the United States and countries within the European Union, believe that Switzerland is a hotbed for maintaining abusive tax avoidance, and that its secrecy laws prevent other countries from effectively combating tax fraud.[129] Changes to the agreement could help Switzerland shake off the recent bad press regarding how its secrecy laws are causing other countries to lose hundreds of millions of dollars in tax revenue.[130] 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 as an epicenter of banking.[131] Concurrently, updates to the convention will help the United States increase its surveillance abilities, assist in closing its tax gap, fulfill its TIEA program goals, and recoup millions in lost tax revenue.[132]

Enacted changes could facilitate more effective tax information exchange between the United States and Switzerland.[133] 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. THE UBS CASE

UBS AG (UBS), based in Switzerland, is one of the largest financial institutions worldwide.[134] Effective January 1, 2001, UBS voluntarily entered into a QI agreement with the IRS.[135] Like in 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

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[127] *Id.*
[128] *See* U.S. Dep't of the Treas., *supra* note 113.
[129] *See* Andrea Coombes, *UBS Case Could Be Major Victory for IRS*, MARKETWATCH.COM, July 11, 2009, http://www.marketwatch.com/story/ubs-case-could-be-major-victory-for-irs.
[130] *See id.*
[131] *Id.*
[132] *See id.*
[133] *See* U.S. Dep't of the Treas., *supra* note 113.
[134] *See* TAX COMPLIANCE AND ENFORCEMENT ISSUES, *supra* note 7, at 2.
[135] *Id.* at 31; Brostek, *supra* note 10, at 10.

maintained with UBS.[136] 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.[137] Further, UBS was to bar the customer from holding any U.S. investments.[138] Eventually, UBS failed to uphold its end of the agreement and the U.S. government felt compelled to bring judicial action.[139]

This Section addresses why UBS became the linchpin in the U.S. attack on bank accounts promoting tax evasion.[140] It outlines the procedure taken against the bank in terms of both criminal and civil judicial action[141] and the policy issues surrounding the litigation.[142] Finally, this Section dissects the outcome of the most current civil litigation facing UBS.[143]

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).[144] This report, as damning to U.S. offshore tax enforcement as was the 2006 PSI report, revealed that many of UBS's American clients refused either to be identified, to have taxes withheld, or to sell their U.S. assets as required under the standing 2001 QI agreement.[145] 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. These entities were then claimed to not be subject to reporting requirements specified under the QI agreement.[146] The report alleges that UBS not only assisted in these tax-evasion schemes, but also purposefully

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[136] *See* TAX COMPLIANCE AND ENFORCEMENT ISSUES, *supra* note 7, at 31.
[137] *See id.*
[138] *Id.*
[139] U.S. v. UBS AG, No. 09-20423-CIV-GOLD/MCALILEY (S.D. Fla. July 9, 2009), *dismissed per stipulation*, Agreement Between the U.S. & Swiss Confederation, 2009 WL 2524345 (2009). *See generally* STAFF REPORT, S. PERMANENT SUBCOMM. ON INVESTIGATIONS*, Tax Haven Banks and U.S. Tax Compliance*, (2008) [hereinafter STAFF REPORT] (released in conjunction with the Permanent Subcommittee on Investigations July 17, 2008 Hearing).
[140] *See generally* Brostek, *supra*, note 10; STAFF REPORT, *supra* note 139.
[141] *See generally* Brostek, *supra*, note 10; STAFF REPORT, *supra* note 139.
[142] *See* Pascal Fletcher & Lisa Jucca, *UBS, U.S. Settle Tax Evasion Case*, REUTERS, Aug. 12, 2009, *available at* http://www.reuters.com/article/2009/08/12/ubs-tax-idUSN129606820090812.
[143] *See id.*
[144] *See generally* STAFF REPORT, *supra* note 139.
[145] *Id*. at 10.
[146] *Id.*

marketed the strategies to wealthy Americans.[147] The 2008 PSI report documented that the United States loses around $100 billion annually to offshore tax evasion.[148] 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 $18-20 billion in assets.[149]

Shortly following the release of this information, Bradley Birkenfeld, an American citizen 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.[150] Birkenfeld's testimony compounded UBS's precarious situation.[151] Specifically, the former director testified that UBS bankers used a variety of ruses to court American clients and to help them dodge taxes.[152] UBS advised bankers traveling to the United States to tell airport customs agents that the trip was for pleasure and not business.[153] Additionally, the bank urged clients to destroy banking records to conceal their offshore accounts.[154] Some American clients were even instructed to "stash" watches, jewelry, and artwork bought with money hidden offshore.[155] UBS went so far as to encourage clients to use Swiss credit cards so the IRS could not track purchases.[156] Birkenfeld further stated that in his official position he served as a courier for his clients, getting checks out of the United States and depositing them in accounts in Denmark, Switzerland, and Liechtenstein.[157] He testified that he knew he was breaking the law but did so because of the "incentives" UBS offered him.[158] 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.[159]

B. The Case

[147] *See id.* at 17; Evan Perez, *Moving the Market: Offshore Tax Evasion Costs U.S. $100 Billion, Senate Probe of UBS, LGT Indicates*, WALL ST. J., July 17, 2008, at C3.
[148] *See* Perez, *supra* note 147.
[149] STAFF REPORT, *supra* note 139.
[150] Lynnley Browning, *Ex-UBS Banker Please Guilty in Tax Evasion*, N.Y. TIMES, June 20, 2008, at C1.
[151] *Id.*
[152] *Id.*
[153] *See id.*
[154] *See id.*
[155] *Id.*
[156] *Id.*
[157] *See id.*
[158] *Id.* (stating these incentives came in the form of large bonuses).
[159] *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.").

A little less than a month prior to the 2008 PSI report's release, the Federal Bureau of Investigation made a formal request to travel to Switzerland to probe a multi-million dollar tax evasion case involving UBS.[160] The UBS fallout subsequently progressed at a furious pace.[161] 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.[162] He pledged that UBS would take progressive action to ensure that the activities identified in the 2008 PSI Report would not continue.[163] He stated that UBS would no longer provide offshore banking services to U.S. customers.[164] Instead, such customers would only be provided services through U.S.-licensed companies.[165] Additionally, UBS would no longer permit Swiss-based advisors to travel to the United States to meet with U.S. customers.[166] Branson further pledged that UBS would comply with a John Doe summons relating to the UBS accounts held by U.S. residents.[167]

The following day, on July 18, 2008, a federal district court in Florida 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.[168] However, UBS's legal troubles did not end there.[169] Through a press release, UBS confirmed on November 12, 2008, that Raoul Weil, Chairman and CEO of UBS Global Wealth Management

[160] Ass'n of Fin. Prof., *FBI to Probe Swiss Bank in UBS Tax Dodging Case*, (June 22, 2008), http://afp.google.com/article/ALeqM5jTfwAG7pDZAUUS8_feZQgnnHAeaQ.

[161] *See* Lynnley Browning, *A 2nd Inquiry Hits UBS, Pressed for 52,000 Names*, N.Y. TIMES, Feb. 20, 2009, at B1 [hereinafter Browning, *A 2nd Inquiry Hits UBS*]; Andrew R. Sorkin, *U.S. Sues UBS to Disclose Customers Names*, N.Y. TIMES, Feb. 19, 2009, http://dealbook.blogs.nytimes.com/2009/02/19/us-sues-ubs-to-disclose-customer-names/.

[162] *United States Senate: Tax Haven Banks and U.S. Tax Compliance, Testimony before the S. Permanent Subcomm. on Investigations on Homeland Sec. and Governmental Affairs*, 110th Cong. 2 (2008) (statement of Mark Branson, CFO of UBS Global Wealth Mgmt. & Swiss Bank Member of the Grp. Managing Bd.).

[163] *See id.*

[164] *Id.*

[165] *See id.*

[166] *See id.*

[167] *Id.*

[168] *See* Levin, *Statement*, *supra* note 11, at 17 (explaining that a John Doe summons is a 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.).

[169] Press Release, UBS AG, Statement on Indictment of UBS Executive (Nov. 11, 2008), *available at* http://www.ubs.com/1/e/investors/releases?newsId=157836.

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 U.S. Department of Justice's ongoing investigation of UBS's U.S. cross-border business.[170] Weil was subsequently relieved of his position with the company.[171]

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.[172] 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 nominee or sham entities.[173] Two hundred million of the $780 million penalty was to be paid to the U.S. Securities and Exchange Commission to settle the charge of "acting as an unregistered broker-dealer and investment advisor" and enforcement action against the bank.[174] 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.[175] The U.S. government agreed to recommend dismissal of the charge if UBS met all monetary and other obligations under the Deferred Prosecution Agreement.[176] In an unprecedented move made 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.[177]

The ink had barely dried on the Deferred Prosecution Agreement before the U.S. government filed a civil suit on February 9, 2009 in a Miami federal district court against UBS to reveal the names of as many

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[170] *See id.*
[171] *See* Carlyn Kolker & Ryan J. Donmoyer, *UBS Executive Weil Charged by U.S. in Tax Conspiracy*, BLOOMBERG, Nov. 12, 2008, *available at* http://www.bloomberg.com/apps/news?pid=20601208&sid=a9920BUoGuF4.
[172] Press Release, U.S. Dep't of Justice, Office of Public Affairs, UBS Enters into Deferred Prosecution Agreement (Feb. 18, 2009), *available at* www.usdoj.gov/opa/pr/2009/February/09-tax-136.html. *See* Brostek, *supra* note 10, at 10. *See generally* U.S. v. UBS AG, No. 09-20423-CIV-GOLD/MCALILEY (S.D. Fla. July 9, 2009), *dismissed per stipulation*, Agreement Between the U.S. & Swiss Confederation, 2009 WL 2524345 (2009).
[173] U.S. Dep't of Justice, *supra* note 172. *See* Brostek, *supra* note 10, at 10. *See generally* U.S. v. UBS AG, No. 09-20423-CIV-GOLD/MCALILEY (S.D. Fla. July 9, 2009), *dismissed per stipulation*, Agreement Between the U.S. & Swiss Confederation, 2009 WL 2524345 (2009).
[174] *See* U.S. Dep't of Justice, *supra* note 172 (stating that UBS also consented to the issuance of a final judgment that permanently enjoined the bank).
[175] *See* TAX COMPLIANCE AND ENFORCEMENT, *supra* note 7, at 32.
[176] *Id.*
[177] *See* U.S. Dep't of Justice, *supra* note 172.

as fifty-two thousand American customers.[178] The Justice Department's lawsuit alleged that the bank and the customers had conspired to defraud the IRS and the U.S. Federal Government of legitimately-owed tax revenue.[179] The suit further alleged that the indicated customers had 32,940 secret accounts containing cash and 20,877 accounts holding securities.[180] The suit claimed that Swiss-based bankers actively marketed UBS's services to wealthy U.S. customers within U.S. borders.[181] Specifically, the government claimed that U.S. contacts occurred through UBS-sponsored sporting and cultural events that targeted wealthy Americans.[182] UBS documents filed with the lawsuit show that UBS bankers came to the United States to meet with U.S. clients almost four thousand times a year, a clear violation of U.S. law.[183] The government stated that the bank trained its officers to avoid detection by U.S. authorities.[184] In addition to the suit, the United States asked a federal judge to enforce the John Doe summons served upon UBS in July of 2008.[185]

UBS, backed by the Swiss government, 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.[186] 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 permitted under the terms of the Deferred Prosecution Agreement.[187] UBS claimed that the IRS's summons sought information regarding a substantial number of undisclosed accounts maintained by U.S. citizens at UBS in Switzerland, whose information is protected by Swiss financial privacy laws.[188] As breaching confidentiality is a criminal offense in Switzerland, to comply with the IRS's summons would mean

[178] *See* Sorkin, *supra* note 161.
[179] *Id.*
[180] *See* David Voreacos & Carlyn Kolker, *U.S. Sues UBS Seeking Swiss Account Customer Names*, BLOOMBERG, Feb. 19, 2009, *available at* http://www.bloomberg.com/apps/news?pid=20601087&sid=axZmpp36b_OA &refer; Browning, *A 2nd Inquiry Hits UBS*, *supra* note 161.
[181] *See* Janet Levaux, *UBS to Fight IRS Search of 52,000 Accounts*, RESEARCH MAGAZINE, Feb. 19, 2009, *available at* http://www.researchmag.com/News/2009/2/Pages/UBS-to-Fight-IRS-.aspx.
[182] *See id.*
[183] *Id.*
[184] *Id.*
[185] *See* Browning, *A 2nd Inquiry Hits UBS*, *supra* note 161.
[186] Fletcher & Jucca, *supra* note 142.
[187] *See* Levaux, *supra* note 181; U.S. v. UBS AG, No. 09-20423-CIV-GOLD/MCALILEY (S.D. Fla. July 9, 2009), *dismissed per stipulation*, Agreement Between the U.S. & Swiss Confederation, 2009 WL 2524345 (2009).
[188] *See* UBS AG, No. 09-20423-CIV-GOLD/MCALILEY.

Swiss UBS employees would have to violate domestic law, resulting in criminal prosecutions in Switzerland.[189] In response to the summons, the Swiss's People's Party called for retaliation against the United States and for urgent debate in Parliament on ways to protect Swiss banking secrecy from "further foreign blackmail."[190]

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.[191] According to John DiCicco, Acting Assistant Attorney General of the Tax Division of the 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.[192] 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.[193] If this were found to be the case, the U.S. government would be permitted to proceed with the criminal prosecution of UBS.[194]

Mark Branson also testified at the 2009 PSI Hearing, but in support of UBS.[195] Branson addressed the progress UBS had made under the requirements of the agreement.[196] He stated that UBS had sought to comply with the John Doe summons without violating Swiss domestic law.[197] According to Branson, Swiss privacy law prohibited UBS from producing responsive information located in Switzerland, which is why UBS had only been able to produce information responsive to the summons that was located in the United States.[198] Branson stated that it was his belief that UBS had currently complied with the summons to the fullest extent possible without subjecting its employees to criminal

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[189] *See id.*; Katharina Bart, *5th Update: Swiss Govt Discusses UBS Vs IRS at Special Mtg*, DOW JONES NEWSWIRES, Aug. 10, 2009 (available from Dow Jones Factiva).
[190] *Swiss Party Wants to Punish U.S. for UBS Probe*, REUTERS, Feb. 21, 2009, *available at* http://www.reuters.com/article/2009/02/21/swiss-usa-idUSTHO15017420090221 .
[191] *See* Branson, *supra* note 162 (released in conjunction with the Permanent Subcommittee on Investigations Mar. 4, 2009 Hearing).
[192] *Tax Haven Banks and U.S. Tax Compliance – Obtaining the Names of U.S. Clients with Swiss Accounts: Hearing Before the S. Comm. On Investigations on Homeland Security and Gov't Affairs*, 111th Cong. 3 (2009) (statement of John DiCicco).
[193] *Id.*
[194] *See id.*
[195] Branson, *supra* note 162.
[196] *Id.*
[197] *Id.*
[198] *Id.*

prosecution in Switzerland.[199] He then emphasized that the United States' continued pressure to enforce the summons would be a violation of the original 2001 QI agreement and the income tax treaty between the two countries.[200]

This warning did not halt U.S. advances in seeking this information.[201] On March 18, 2009, the Department of Justice extended its investigation into UBS offshore tax fraud to include independent attorneys and accountants in Switzerland and the United States.[202] Of three individuals currently under investigation, one is a Zurich-based accountant who runs a boutique finance and trust company,[203] and two are brothers who are attorneys at a law firm located in Zurich and Geneva.[204] A criminal case is being built against these individuals, who are each suspected of having traveled with Swiss UBS bankers to the United States to work with American clients to evade U.S. taxes.[205] On April 2, 2009, Steven Rubenstein of Boca Raton, Florida became the first U.S. citizen arrested in connection with the tax probe of UBS, allegedly hiding assets at UBS in order to avoid tax collectors.[206] Rubenstein—a yacht company accountant—deposited more than $2 million in Kruggerrand gold coins into his UBS accounts and bought securities worth more than 4.5 million Francs.[207] He is also accused of meeting with UBS Swiss bankers in several locations around South Florida from 2001 to 2008.[208] On August 10, 2009, Rubenstein signed a plea agreement with the Department of Justice consenting to these charges in exchange for lowered sentencing guidelines.[209]

Fuel was added to the fire when Jeffrey 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 $8 million through offshore accounts with UBS and another

[199] *Id.*
[200] *See id.*
[201] *See generally* Lynnley Browning, *U.S. Extends Its Inquiry of Offshore Tax Fraud*, N.Y. TIMES, Mar. 18, 2009, at B3.
[202] *Id.*
[203] *See* TAX COMPLIANCE AND ENFORCEMENT ISSUES, *supra* note 7, at 34 (stating that the individual is Beda Singenberger).
[204] *See id.* (stating that the individuals are Matthias W. and Andreas M. Rickenbach).
[205] *See id.*
[206] Ass'n of Fin. Prof., *Florida Man First to be Charged in UBS Tax Fraud*, (Apr. 2, 2009), http://www.google.com/hostednews/afp/article/ALeqM5i8DNlP43ZSRdO49RQVNlLENiluSA.
[207] *See id.*
[208] *Id.*
[209] *See generally* Plea Agreement of Defendant, *U.S. v. Rubenfeld* No. 09-60166 (S.D. Fla. Aug. 10, 2009).

unnamed Swiss bank.[210] Chernick testified that for the past decade, he had used offshore accounts in the two banks expressly to avoid taxation.[211] According to Chernick, the Swiss bankers removed his name and account numbers from his offshore account statements and lied to U.S. customs agents regarding their reasons for traveling to the United States.[212] He also testified that there was a $45,000 bribe allegedly paid to a Swiss official on Chernick's behalf in order to obtain information on the U.S. investigation into UBS.[213] 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 to repatriate funds into the United States to purchase property for his home in New York.[214]

C. Outcome

With the trial date fast approaching, the U.S. government and UBS reported in a status conference meeting with U.S. District Judge Alan Gold that they had reached an "agreement in principle."[215] 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.[216] 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.[217]

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.[218] Under this reported plan, UBS would be required to reveal data only if the client had been visited by Swiss bankers outside the United States.[219]

On August 12, 2009, the parties initialed a more substantive agreement, acknowledging it would "take a little time" to sign this

210 *See* David Stewart, *Third UBS Client to Plead Guilty Implicates Unnamed Bank, Swiss Official*, TAX ANALYSTS, July 29, 2009 (Doc. 2009-17064); Martha Brannigan, *UBS Bank Customer Pleads Guilty in Tax Case*, THE MIAMI HERALD (July 28, 2009).
211 See Brannigan, *supra* note 210.
212 *Id.*
213 *Id.*
214 *See id.*
215 Kevin McCoy, *Justice Dep't, UBS Close to Deal on Swiss Tax Secrecy*, USA TODAY (July 31, 2009), *available at* http://www.usatoday.com/money/perfi/taxes/2009-07-31-UBS-tax-evasion_N.html; David Stewart, *Officials Report 'Agreement in Principle' in UBS Dispute*, TAX ANALYSTS, July 31, 2009 (Doc. 2009-17337).
216 *See* McCoy, *supra* note 215.
217 *See* Stewart, *supra* note 215.
218 *Id.*
219 *Id.*

agreement in a final form.[220] 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.[221] Swiss banking 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.[222] This "fraud exception" was the same principle cited when the bank previously disclosed the names of about two hundred and fifty UBS clients in conjunction with the Deferred Prosecution Agreement.[223] Additionally, leaked details of what would be in the finalized agreement indicated that the UBS-U.S. settlement may prevent a monetary penalty from being levied against the bank.[224] This is welcoming news to many investors who feared UBS would have to pay several billion dollars to settle the dispute.[225]

V. ANALYSIS

Switzerland, normally considered a bastion of banking secrecy, has come under heavy pressure from the United States, Germany, France, and Britain to improve practices relating to the enforcement and punishment of tax evaders.[226] In response to this pressure, this Section addresses the changes to the current U.S.-Swiss TIEA,[227] the future of Swiss banking privacy law and how it will affect U.S. offshore banking activity,[228] and the character of policy decisions.[229]

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

Changes were bound to be made to the U.S.-Swiss TIEA given the enormous amount of civil and criminal litigation involving Swiss banks, coupled with the U.S. government's unyielding commitment to eliminate

[220] *See* Fletcher & Jocca, *supra* note 142.
[221] *See id.*
[222] *See* Stewart, *supra* note 215.
[223] *Id.*
[224] David Stewart, *U.S. Deal with Swiss Bank UBS May Prevent Monetary Penalty*, TAX ANALYSTS, Aug. 4, 2009 (Doc. 2009-17541).
[225] *See id.* (stating these fears were fueled by UBS's June 25 announcement that the bank would raise $3.5 billion in a share offering to institutional investors).
[226] *See* Crutsinger, *supra* note 6.
[227] *See generally id. See also* Randall Jackson, *Switzerland-U.S. Tax Treaty to be Revised*, TAX ANALYSTS, Apr. 7, 2009 (Doc. 2009-17944).
[228] *See* David Stewart, *Parties Seek Third Delay in UBS Hearing as Negotiations Continue*, TAX ANALYSTS, Aug.7, 2009 (Doc. 2009-17948).
[229] *See generally* David Stewart, *Negotiations Continue as UBS Hearing Approaches*, TAX ANALYSTS, July 30, 2009 (Doc. 2009-17176).

abusive offshore tax schemes and offshore accounts which lead to gross tax evasion.[230] According to a June 19, 2009 Department of Treasury press release, the United States and Switzerland governments had concluded negotiations on an amended tax treaty.[231] The countries were then expected to sign the protocol within a few months' time,[232] once Swiss business and local governments were given the chance to comment on the proposed changes.[233] Switzerland's Federal Council and Parliament will decide if the new agreement is permitted to take effect.[234] 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. lawmakers.[235] 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 (OECD).[236]

B. Future of Swiss Banking Privacy Vis-à-Vis The United States

The United States' case against UBS has strained relations between the United States and Switzerland because of the blatant challenge to Switzerland's diligently guarded banking secrecy laws.[237] 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 in America.[238] In disclosing names, UBS could face more civil suits from account holders claiming that UBS violated Swiss bank secrecy laws by including their names and account information in any disclosure.[239] UBS employees may also face criminal prosecution under Swiss law for breaching confidentiality.[240] All of this is likely to cause significant political backlash in Switzerland to defend its sovereignty, especially as it relates to the United States.

The banking sector is such a large employer in Switzerland, and such a strong source of pride among the Swiss population, that no Swiss

[230] *See generally id. See also* Jackson, *supra* note 227.
[231] Press Release, U.S. Dep't of the Treas., Office of Pub. Affairs, United States, Switzerland Agree to Increased Tax Information Exchange (June 19, 2009) *available at* http://www.treas.gov/press/releases/tg177.html.
[232] *See* U.S. Dept of the Treas., *supra* note 231.
[233] Crutsinger, *supra* note 6.
[234] *See id.*
[235] *See id.*
[236] *See id.*
[237] *See* McCoy, *supra* note 215.
[238] *Id.*
[239] *See id.*
[240] *See id.*

government can eliminate these laws without severe political repercussions. 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. Swiss Foreign Minister Micheline Calmy-Rey understands this, and, in response to the UBS litigation, stated, "It is about Switzerland's sovereignty. We want our laws to be respected. It is also about our financial centers and about jobs."[241] Thus, the government will likely continue to strengthen its bank secrecy violation penalties on the one hand, while on the other doing as little as possible to placate the United States with respect to U.S. citizens with unreported Swiss accounts.

The Swiss judicial system is also very likely to take umbrage to the United States' attempt to abrogate its laws. The reaction could include strict and severe enforcement of bank secrecy violation penalties and criminal sentences. Historically, the Swiss judiciary has often looked at the application of U.S. laws by U.S. judges to U.S. citizens doing business in Switzerland as interference with domestic sovereignty, rather than a proper application of U.S. laws. However, where a U.S. case has involved the fraudulent conduct of a wealthy American citizen, the Swiss Courts have been somewhat compliant. In this case, the United States is seeking to enforce its laws in Switzerland on American citizens who have properly obtained their wealth, but who have fraudulently not reported such wealth for U.S. tax purposes. As such, the United States 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 is likely to create changes to offshore banking opportunities and banking secrecy laws in addition to the revised U.S.-Swiss TIEA. The United States 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,[242] and the true purpose and effect of bringing the UBS case.

i. Meddling in other countries' sovereignty

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[241] *Id.*
[242] *See* Stewart, *supra* note 229.

The United States today seems to interpret its national interest in terms of projection of U.S. power overseas in addition to protecting its own borders. This foreign projection has extended from military power to taxing power. The United States also runs an enormous budget deficit. Since it has one of the few "worldwide taxation" systems, the United States has the power to locate all assets of all citizens that may produce income to ensure compliance of its tax laws. The budget deficit puts pressure on tax collectors to do so by any means necessary. This has lead the United States 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, nothing stands in the way of another sovereign country passing laws, in the name of its national interest, that would interfere with American citizens' rights. In a world that is increasingly connected, the United States cannot afford to abrogate other countries' laws, especially the laws of a friendly country 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 United States can effect a domestic law change that affects a foreign sovereign's domestic laws, there is no reason that another country could not do the same to the United States. It is not in the United States' national interest to stand alone in the world with a position that it need not respect foreign laws, but that other sovereign nations must respect U.S. laws.

ii. True purpose of the UBS case and effect

On the surface, the reason that the United States brought the UBS case appears to have been to identify the names of American citizens who had unreported foreign bank accounts overseas at UBS. The United States, however, probably had a much broader purpose in bringing the case. The broader purpose was probably to have a deterrent effect on foreign banks and advisors who assist in creating or facilitating foreign bank accounts. The myriad network of non-U.S. banks, other financial institutions, advisors, and other facilitators (collectively referred to as the "Network") is so deep and vast that there is no way that the United States could effectively 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 was the first, and most important, step in the process. Following that step, incentivizing U.S. taxpayers to voluntarily come forward was the next most important step because it had the effect of making the Network aware that U.S. taxpayers may come forward even without punishing the Network itself. The totality of the U.S. attack is such that many foreign banks will no longer accept American citizens as clients. Whereas the common wisdom offshore used to be that the IRS could not reach foreign jurisdictions to reach the Network, today the opposite conclusion is widely believed. Thus, as long as the United States continues its attack, the deterrent goal will likely be met.

Obviously, the more press the United States receives about cracking down on offshore account holders and the Network, the more of a deterrent effect there will be on American citizens who might otherwise contemplate opening up an unreported foreign bank account. If the IRS and the U.S. government are able get the names of U.S. accountholders at UBS, this could be a very large weapon in the U.S. government's arsenal.[243] Lastly, with increased scrutiny of offshore accounts, owners may have limited access to their money.[244]

VI. CONCLUSION

The United States 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 American citizens have made extensive use of offshore tax havens to evade taxes, and that traditional law enforcement is unable to control such misconduct.[245] It makes sense that the largest offshore banking 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 United States would seek to get a more favorable TIEA in place with Switzerland.[246]

The problem with the United States' attack on UBS is not its goals, but rather its methods. The United States has traditionally been steadfast in protecting itself from encroachment by laws of other sovereign nations that contradict U.S. laws. Given this position, the United States appears to be trying to have it both ways with the rest of the world—other

[243] *See* Coombes, *supra* note 129.
[244] *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.").
[245] *See generally* TAX HAVEN ABUSES, *supra* note 1.
[246] *See* Crutsinger, *supra* note 6.

countries must follow U.S. laws but they should not attempt to make the United States follow their laws. Given this contradiction, it is understandable that the Swiss are concerned that the United States is not respecting Swiss domestic law. The United States, 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 Switzerland.