

# Piercing the Veil of Bank Secrecy? Assessing the United States' Settlement in the UBS Case

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## Introduction

Offshore tax havens cost the United States approximately \$100 billion per year; worldwide, the revenue losses from tax havens may be over \$250 billion.<sup>1</sup> Large-scale tax evasion can erode national tax bases, alter the structure of taxation by shifting part of the tax burden to less mobile sectors of the economy, and distort trade and investment patterns.<sup>2</sup> In the wake of the global financial crisis, increasingly indebted governments have focused more on tax havens and tax evasion as part of their efforts to increase government revenues and foster a more transparent global financial system.<sup>3</sup>

Perhaps the most high-profile illustration of government action against offshore tax evasion is the case involving Union Bank of Switzerland AG (UBS). From 2000 until 2007, UBS assisted U.S. clients in concealing their offshore accounts from the Internal Revenue Service (IRS) by failing to ensure that the clients complied with their disclosure obligations.<sup>4</sup> UBS also helped U.S. clients open accounts in the names of sham entities to act as foreign beneficial owners of the accounts; then, because the clients would falsely provide UBS with the tax form indicating ownership by a foreign entity UBS was able to evade its reporting obligations to the IRS.<sup>5</sup> Additionally, UBS bankers routinely traveled to the United States to market Swiss bank secrecy to U.S. clients.<sup>6</sup> In 2008, the IRS successfully petitioned the U.S. District Court for the Southern District of Florida for leave to serve a summons on UBS demanding that UBS disclose records of U.S. persons who maintained unreported accounts at UBS in Switzerland.<sup>7</sup>

1. STAFF OF S. COMM. ON HOMELAND SEC. AND GOVERNMENTAL AFFAIRS, PERM. SUB-COMM. ON INVESTIGATIONS, 110TH CONG., REPORT ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE 1 & n.1 ¶2008 [hereinafter REPORT ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE], available at [http://hsgac.senate.gov/public/\\_files/071708PSIRreport.pdf](http://hsgac.senate.gov/public/_files/071708PSIRreport.pdf). Although having an account in an offshore location is not inherently illegal, legal issues arise when U.S. taxpayers with financial arrangements in these jurisdictions fail to report income earned in their foreign accounts or fail to file the required reports with the Internal Revenue Service (IRS). See Robert S. Fink & Bryan C. Skarlatos, *Foreign Bank-Secrecy Laws: Making Amends with the IRS*, N.Y.L.J., Sept. 3, 2008, at 4.

2. ORG. FOR ECON. CO-OPERATION & DEVELOPMENT (OECD), HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE 14 (1998) [hereinafter OECD REPORT], available at <http://www.oecd.org/dataoecd/33/1/1904184.pdf>.

3. See JAMES K. JACKSON, CONG. RESEARCH SERV., THE OECD INITIATIVE ON TAX HAVENS 1 (2009), available at [http://assets.opencrs.com/rpts/R40114\\_20090724.pdf](http://assets.opencrs.com/rpts/R40114_20090724.pdf).

4. Deferred Prosecution Agreement, Exhibit C, Statement of Facts at 3, United States v. UBS AG, No. 09-60033 (S.D. Fla. February 19, 2009). The U.S. clients were obligated to provide their taxpayer identification numbers to UBS on Form W-9 so that UBS could report their income to the IRS by filing Form 1099. Ex Parte Petition for Leave to Serve John Doe Summons, No. 08-21864, at 3-4 (S.D. Fla. June 30, 2008).

5. *Id.* at 1-2, United States v. UBS AG, No. 09-60033 (S.D. Fla. Feb. 19, 2009).

6. *Id.* at 2.

7. See generally Memorandum in Support of Ex Parte Petition for Leave to Serve John Doe Summons, In the Matter of the Tax Liabilities of John Does, United States v. UBS AG, No. 08-21864 (S.D. Fla. June 30, 2008). The IRS stated that the summons would ask UBS for the names of U.S. clients who held accounts anytime between 2002 and 2007 for whom UBS: "(1) did not have in its possession Forms W-9 executed by such United States taxpayers, and (2) had not filed timely and accurate Forms 1099

UBS failed to respond to the served summons.<sup>8</sup>

On February 19, 2009, the Department of Justice (DOJ) criminal investigation of UBS ended in a Deferred Prosecution Agreement; under the terms of the agreement, UBS will provide the U.S. government with the names of 200 to 300 U.S. clients of UBS's cross-border business, exit the business of providing banking services to U.S. clients with undeclared accounts, and pay a total of \$780 million in fines and penalties.<sup>9</sup> The same day, the DOJ filed a petition in the district court to enforce the summons.<sup>10</sup> The court set a July 13, 2009 hearing date to determine whether to order UBS to disclose the names of U.S. clients to the government.<sup>11</sup> In response to the petition, UBS argued that Swiss banking secrecy laws, the Switzerland-U.S. income tax treaty, and principles of comity militated against disclosure of the U.S. taxpayers' information.<sup>12</sup> The Swiss government joined the litigation as *amicus curiae*, insisting that the United States could only obtain the account information through a request under the information sharing article of the 1996 Switzerland-U.S. tax treaty.<sup>13</sup>

Ultimately, the dispute between the DOJ and UBS transformed into a dispute between the U.S. and Swiss governments and was resolved out of court. After negotiations that delayed the scheduled July hearing on the enforcement of the summons,<sup>14</sup> the United States and Switzerland reached an agreement on August 19, 2009, providing that Switzerland would process the disclosures through a treaty request.<sup>15</sup> Pursuant to the agreement, Switzerland will produce the identities of 4,450 UBS account-holders.<sup>16</sup> In return, the United States will withdraw the John Doe summons on or after January 2010, once it has received information on 10,000 UBS accounts

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naming such United States taxpayers and reporting to United States taxing authorities all reportable payments made to such United States taxpayers." *Id.* at 5.

8. In the Matter of the Tax Liabilities of John Does, United States v. UBS AG, No. 08-21864 (S.D. Fla. July 1, 2008) (order granting IRS leave to serve John Doe summons to UBS AG); see also Petition to Enforce John Doe Summons at 4, United States v. UBS AG, No. 08-21864 (S.D. Fla. Feb. 19, 2009), available at [http://www.justice.gov/tax/UBS\\_Petition\\_to\\_Enforce\\_John\\_Doe\\_Summons.pdf](http://www.justice.gov/tax/UBS_Petition_to_Enforce_John_Doe_Summons.pdf) ("To date, UBS has failed to comply in full with the summons.").

9. Deferred Prosecution Agreement, Exhibit C at 3-4, United States v. UBS AG, No. 09-60033 (S.D. Fla. Feb. 19, 2009).

10. Petition to Enforce John Doe Summons, United States v. UBS AG, No. 09-20423 (S.D. Fla. Feb. 19, 2009).

11. See Lynnley Browning, *UBS May Face Trial on U.S. Demand for Client's Names*, N.Y. TIMES, Feb. 24, 2009 at B4.

12. Brief of UBS AG in Opposition to the Petition to Enforce the John Doe Summons at 1-4, United States v. UBS AG, No. 09-20423 (S.D. Fla. Apr. 30, 2009).

13. Amicus Brief of Government of Switzerland at 11, United States v. UBS AG, No. 09-20423 (S.D. Fla. Apr. 30, 2009).

14. JACKSON, *supra* note 3, at 3.

15. Agreement on the Request for Information from the Internal Revenue Service of the United States of America Regarding UBS AG, a Corporation Established Under the Laws of the Swiss Confederation art 1(1), U.S.-Switz., Aug. 19, 2009, LEXIS 2009 WTD 159-26 [hereinafter UBS Agreement], available at <http://www.justice.gov/opa/documents/us-swiss-agreement.pdf>.

16. *Id.*

through any source.<sup>17</sup>

The agreement represents a limited victory over Swiss bank secrecy laws. The Annex to the agreement sets forth the criteria that the Swiss government will use in determining which accounts to disclose.<sup>18</sup> Because the criteria for disclosing certain accounts reflect a broader interpretation of tax fraud, the Swiss will disclose some accounts that its bank secrecy laws would normally protect.<sup>19</sup> The agreement did not alter the right of clients under Swiss law to appeal disclosure, however, and some clients have taken advantage of this loophole.<sup>20</sup>

The IRS also relied on a voluntary disclosure program to reach more than the 4,450 UBS accounts processed through the treaty request.<sup>21</sup> The program allowed certain offshore account-holders to avoid criminal prosecution and pay reduced penalties.<sup>22</sup> The United States and Switzerland did not announce which accounts were subject to the treaty request for ninety days following the signing of the UBS settlement<sup>23</sup> to pressure account-holders of undisclosed foreign bank accounts to come forward to U.S. authorities.<sup>24</sup> The IRS strategy to encourage participation in the program resulted in more than 14,700 individuals coming forward, more than 12,000 of them after the UBS settlement.<sup>25</sup>

Though the IRS regarded the UBS settlement as “a major step” toward “piercing the veil of bank secrecy,”<sup>26</sup> this Note argues that the United States should not have settled the summons enforcement action by agreeing to obtain the UBS accounts through a treaty request. Not only was the summons enforceable under U.S. legal precedents, what the United States

17. See *id.* art. 3(4). Potential sources of information include the treaty request, voluntary disclosure, the DPA, and the client’s waiver of bank secrecy. See *id.* art. 2 n.2.

18. See *id.* Annex [hereinafter Annex], available at [http://www.financialtaskforce.org/wp-content/uploads/2009/11/Swiss\\_US\\_UBS\\_Annex-Final.pdf](http://www.financialtaskforce.org/wp-content/uploads/2009/11/Swiss_US_UBS_Annex-Final.pdf) (“Criteria for Granting Assistance Pursuant to the Treaty Request”).

19. See David D. Stewart, *IRS Releases UBS Agreement Criteria*, 56 TAX NOTES INT’L 563, 564 (2009).

20. See Lee Sheppard, *Justice Department Reacts to Swiss Disclosure Case*, 57 TAX NOTES INT’L 412, 412 (2010).

21. See UBS Agreement, *supra* note 15, art. 1(4) (“With a view to accelerating the processing of the Treaty Request by the SFTA, the IRS will promptly request all UBS clients who enter into the voluntary disclosure program on or after the signing of this Agreement to give a waiver to UBS AG to provide account documentation to the IRS.”).

22. See INTERNAL REVENUE MANUAL § 9.5.11.9 (June 26, 2009), <http://www.irs.gov/newsroom/article/0,,id=104361,00.html> (“voluntary disclosure will be considered . . . in determining whether criminal prosecution will be recommended.”); Laura Saunders & Carrick Mollenkamp, *Tax Evaders Flock to IRS to Confess Their Sins*, WALL ST. J., July 30, 2009, at A1.

23. UBS Agreement, *supra* note 15, art. 6. The IRS publicly released the criteria on November 17, 2009. Stewart, *supra* note 19, at 563.

24. See David S. Hilzenrath, *Swiss No Longer Shielding Biggest U.S. Tax Dodgers*, WASH. POST, Nov. 18, 2009, at A13.

25. *Id.* The figures include non-UBS accountholders. IRS Commissioner Douglas Shulman did not provide a subtotal for UBS. In fact, the IRS pushed back the original deadline of the program to accommodate the surge in interest from taxpayers. *Id.*

26. David D. Stewart, *UBS to Turn Over 4,450 Account Names*, 55 TAX NOTES INT’L 587, 588 (2009).

obtained from the treaty request is deficient in substance and as a matter of future tax enforcement policy. Part I briefly defines tax havens and explains methods of tax evasion by individuals. Part II describes current U.S. unilateral and multilateral tax enforcement methods, as well as recent proposals for change. Part III presents the legal authority supporting enforcement of the John Doe summons in the UBS case. Part IV assesses the UBS settlement, including its implications for future tax enforcement.

## I. Understanding Tax Havens and Tax Evasion

### A. Defining Tax Havens

The term “tax haven” refers to countries that impose little or no tax on income from sources outside their jurisdiction and have in place bank secrecy laws that protect the relationship between the banker and the client by criminalizing the revelation of information obtained from their relationship.<sup>27</sup> Foreign investment activity in a tax haven is primarily financial, with little movement of real capital; such activity is substantial relative to the total size of the tax haven’s economy.<sup>28</sup> A tax haven typically has a stable government (the majority are members of the Commonwealth), good transportation and communications, and a freely convertible currency.<sup>29</sup>

In a landmark report issued in 1998, the Organization for Economic Cooperation and Development (OECD) proposed to identify tax haven and “tax-preferential” jurisdictions by examining the following features: (1) domestic tax rates, (2) relationship between foreign investment and domestic economic activity, (3) effective information exchange and (4) financial transparency.<sup>30</sup> The report warned that tax havens often produce distorting effects on trade and investment and threaten to erode national tax bases.<sup>31</sup> The report was particularly critical of tax regimes lacking effective information exchange and financial transparency, because such features not only intentionally or foreseeably facilitate tax evasion, but also enable other financial crimes (such as money laundering).<sup>32</sup> The OECD recommended numerous measures in the areas of domestic legislation, tax treaties, and international cooperation that countries may pursue to counter harmful tax competition.<sup>33</sup> All OECD member nations, except Luxem-

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27. See C. Todd Jones, *Compulsion Over Comity: The United States’ Assault on Foreign Bank Secrecy*, 12 NW. J. INT’L L. & BUS. 454, 461 (“[i]n general . . . havens have a legal system in place that protects the relationship between bank and client”).

28. See Robert T. Kudrle, *Ending the Tax Haven Scandals*, GLOBAL ECON. J., Vol. 9, Issue 3, at 1 (2009).

29. *Id.* Commonly appearing on lists of tax havens are Andorra, Liechtenstein, Monaco, Switzerland, the Cayman Islands, Singapore, Hong Kong, and Bermuda. *Id.*

30. OECD REPORT, *supra* note 2, at 19–27. Specifically, the OECD proposed to differentiate between “tax havens” and “preferential regimes,” but considered both types “harmful tax practices.” *Id.* at 8.

31. *Id.* at 8.

32. *Id.* at 24.

33. See generally *id.*

bourg and Switzerland, approved the report.<sup>34</sup>

## B. Methods of Tax Evasion by Individuals

Under U.S. law, the crime of tax evasion is the willful attempt in any manner to evade a tax or its payment.<sup>35</sup> Although the means constituting an attempt are unlimited, there must be an affirmative act by the taxpayer;<sup>36</sup> an omission, such as failing to file a return, is not an attempt to evade.<sup>37</sup> Willfulness under the statute is the “voluntary, intentional violation of a known legal duty.”<sup>38</sup> The trier of fact must generally infer willfulness from the defendant’s conduct;<sup>39</sup> conduct from which willfulness may be inferred includes, but is not limited to,

keeping a double set of books, making false entries or alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering up sources of income, handling of one’s affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely effect of which would be to mislead or to conceal.<sup>40</sup>

The crime of tax evasion also requires the existence of a tax deficiency.<sup>41</sup>

In confronting the issue of harmful tax practices, the OECD report noted how international financial globalization has provided new ways for companies and individuals to minimize and avoid taxes, and in turn how countries take advantage of these new opportunities by implementing tax policies designed to attract mobile capital.<sup>42</sup> In addition, the development of electronic means of delivering services and transferring funds has increased the potential for tax evasion.<sup>43</sup>

One form of tax evasion is failure to report income from foreign bank accounts or from stocks and bonds purchased outside the United States.<sup>44</sup> Because the United States taxes U.S. persons on their worldwide income, this income is taxable under U.S. law.<sup>45</sup> The IRS has difficulty detecting undeclared accounts partly because the United States does not require

34. Martin A. Sullivan, *Lessons from the Last War on Tax Havens*, 116 TAX NOTES 327, 327 (2007).

35. I.R.C. § 7201 (2006).

36. BNA Tax Management Portfolios 636-2nd T.M., Tax Crimes § I-A at A-1 (2008); TAX DIVISION, U.S. DEP’T OF JUSTICE, CRIMINAL TAX MANUAL § 8.04 (2001).

37. I.R.C. § 7203 (punishing failure to file a return as a separate misdemeanor offense); CRIMINAL TAX MANUAL § 8.04.

38. *U.S. v. Pomponio* 429 U.S. 10, 12 (1976).

39. CRIMINAL TAX MANUAL § 8.06.

40. *Id.* (quoting *Spies v. United States*, 317 U.S. 492, 499 (1943)).

41. BNA Tax Management Portfolios 636-2nd T.M., Tax Crimes § I-A at A-1 (2008).

42. OECD REPORT, *supra* note 2, at 14. The globalized economy also increases the potential of one country’s tax policies to impose spillover effects on other countries. *Id.*

43. See JANE G. GRAVELLE, CONG. RESEARCH SERV., TAX HAVENS: INTERNATIONAL AVOIDANCE AND EVASION 19 (2009), available at [http://assets.opencrs.com/rpts/R40623\\_20090709.pdf](http://assets.opencrs.com/rpts/R40623_20090709.pdf).

44. *Id.*

45. See I.R.C. § 61 (2006) (“gross income means all income from whatever source derived”).

much withholding information for offshore financial transactions.<sup>46</sup> Individuals can also evade taxes by channeling their income-earning activities through foreign entities, such as shell corporations and trusts.<sup>47</sup>

These abusive offshore tax schemes take advantage of differences in the way the United States taxes U.S. as compared to foreign persons.<sup>48</sup> In contrast to its treatment of U.S. persons, the United States does not tax foreign persons (nonresident aliens and foreign corporations) on certain types of investment income originating in the United States.<sup>49</sup> Although nonresidents are generally subject to a 30% withholding tax on U.S. source investment income,<sup>50</sup> several types of income realized by nonresidents is excluded from gross taxation at source, including interest paid on bank deposits, portfolio interest, and most capital gains.<sup>51</sup> Thus, U.S. taxpayers aiming to evade taxes can create foreign accounts or entities to give the appearance that their assets and income are owned by foreign persons.

An offshore tax scheme might work in the following way. A U.S. resident could easily open a foreign bank account electronically in a tax haven jurisdiction in the name of a tax haven corporation.<sup>52</sup> The individual could then deposit funds into the account from the United States or from abroad.<sup>53</sup> Finally, the individual would be able to use the funds in the tax haven account to invest in the United States<sup>54</sup>

The U.S. information reporting system permits the scheme to go undetected by U.S. tax authorities and thus enables the U.S. resident who beneficially owns the account to evade tax on U.S. source income.<sup>55</sup> Whereas a U.S. bank that pays interest on deposits must generally report the amount paid and the identity of the recipient to the IRS,<sup>56</sup> the bank has no reporting obligation if the recipient provides the bank with documentation that it

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46. See GRAVELLE, *supra* note 43, at 19.

47. See *id.*

48. See generally IRS, *Abusive Offshore Tax Avoidance Schemes: Law and Arguments* § 1, <http://www.irs.gov/businesses/small/article/0,,id=106562,00.html>.

49. See *id.*

50. See I.R.C. §§ 871(a)(1), 881(a)(1); Treas. Reg. § 1.1441-1 (2009) ("Requirement for the deduction and withholding of tax on payments to foreign persons"); see also I.R.C. § 872 ("In the case of a nonresident alien individual . . . gross income includes only (1) gross income which is derived from sources within the United States and which is not effectively connected with the conduct of a trade or business within the United States, and (2) gross income which is effectively connected with the conduct of a trade or business within the United States."); I.R.C. § 881 (foreign corporations not connected with U.S. businesses); see generally STAFF OF JOINT COMM. ON TAXATION, 111TH CONG., TAX COMPLIANCE AND ENFORCEMENT ISSUES WITH RESPECT TO OFFSHORE ACCOUNTS AND ENTITIES 2 (COMM. PRINT 2009) [hereinafter JCT REPORT], available at <http://www.jct.gov/x-23-09.pdf>.

51. See Treas. Reg. § 1.1441-1(b)(4) ("List of exemptions from, or reduced rates of, withholding under chapter 3 of the Code"); JCT REPORT, *supra* note 50, at 6.

52. Joseph Guttentag & Reuven Avi-Yonah, *Closing the International Tax Gap*, in BRIDGING THE TAX GAP: ADDRESSING THE TAX GAP IN FEDERAL TAX ADMINISTRATION, ECONOMIC POLICY INSTITUTE 99 (Max B. Sawicky ed., 2005).

53. See *id.* at 99.

54. See *id.* at 99-100.

55. See *id.*

56. See I.R.C. § 6049(a) (2006); Treas. Reg. § 1.6049-4 (2009).

is a foreign payee.<sup>57</sup> Therefore, if the U.S. resident falsely represents on Form W-8 that he is a foreign payee, the bank will not report the resident's investment income to the IRS.<sup>58</sup> This false documentation of status is possible because information-reporting rules entitle the bank to rely on a valid Form W-8 if the bank does not know or have reason to know of the misrepresentation.<sup>59</sup>

## II. Tools to Enforce U.S. Tax Laws Abroad

### A. Unilateral Measures to Obtain Foreign-Based Documents

Among the information gathering tools the IRS has at its disposal to examine taxpayer books and records is the summons. The IRS may compel any person to produce documents upon request and compel any person to testify under oath.<sup>60</sup> The scope of the summons power encompasses the following purposes: to ascertain the correctness of any return, to determine whether a return should be made when none was filed, to determine the liability of any person for any internal revenue tax, and to collect any such liability.<sup>61</sup> Additionally, the summons power broadly includes "inquiring into any offense connected with the administration or enforcement of the internal revenue laws" and obtaining information that "may be relevant or material to such inquiry."<sup>62</sup> The relevance standard does not require the IRS to correctly determine that the taxpayer owes additional taxes in order for a summons to issue.<sup>63</sup> Rather, the IRS can investigate merely on suspicion of a violation of the law, or to gain assurance that a violation has not occurred.<sup>64</sup>

Federal district courts are authorized to compel compliance with the summons.<sup>65</sup> In an action to enforce a summons, the United States must prove a *prima facie* case for enforcement by establishing the following four

57. See I.R.C. § 6049(b)(2) (providing that information reporting is not required for any "amount" subject to withholding under § 1441 or listed in § 871 (i)(2)); Cynthia Blum, *Sharing Bank Deposit Information with Other Countries: Should Tax Compliance or Privacy Claims Prevail?*, 6 FLA. TAX REV. 579, 584 (2004).

58. Blum, *supra* note 57, at 584-85.

59. Treas. Reg. § 1.1441-1(e)(1)(i) ("Absent actual knowledge or reason to know otherwise, a withholding agent may treat a payment as made to a foreign beneficial owner in accordance with the provisions of paragraph (e)(1)(ii) of this section."). A withholding agent can treat a payment as made to a beneficial owner if the "the withholding agent can reliably associate the payment with a beneficial owner withholding certificate." Treas. Reg. § 1.1441-1(e)(1)(ii)(I).

60. I.R.C. § 7602(a).

61. I.R.C. § 7602(a).

62. I.R.C. §§ 7602(a)(2), 7602(b).

63. William M. Sharp & Hale E. Sheppard, *Privilege, Work-Product Doctrine, and Other Discovery Defenses in U.S. IRS's International Tax Enforcement*, 32 TAX NOTES INT'L 377, 386-87 (2003).

64. See *U.S. v. Powell*, 379 U.S. 48, 57 (1964) (analogizing the summons power to the Federal Trade Commission's summons power, which "does not depend on a case or controversy for power to get evidence but can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not." (citations omitted)).

65. I.R.C. §§ 7402(b), 7604.

elements (the “Powell factors”): (1) the summons was issued for a legitimate purpose, (2) the summoned information may be relevant to that purpose, (3) the summoned information is not already in the possession of the IRS, and (4) the IRS has taken all necessary administrative steps.<sup>66</sup> Once the United States makes this showing, “the burden shifts to the taxpayer to disprove one of the four elements of the government’s prima facie showing or to convince the court that enforcement of the summons would constitute an abuse of the court’s process.”<sup>67</sup>

The IRS has the authority to summon information from third parties that have business or professional relationships with the taxpayer.<sup>68</sup> To discover the identity of unknown taxpayers, the IRS can also use a special third-party summons, known as a John Doe summons, which does not specifically identify the taxpayer whose records are sought.<sup>69</sup> The IRS may serve the John Doe summons only after it establishes in an *ex parte* court proceeding that:

the summons relates to the investigation of a particular person or ascertainable group or class of persons; (2) there is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law; and (3) the information sought to be obtained from the examination of the records (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources.<sup>70</sup>

Thus, the IRS can satisfy the standard to obtain a John Doe summons with circumstantial evidence indicating that reporting errors or omissions have occurred in the transaction at issue; such evidence need not conclusively establish an actual tax violation.<sup>71</sup>

Where the bank accounts sought by the IRS reside in a foreign jurisdiction with bank secrecy laws, the summoned party may raise the defense that compliance with the summons will violate the law of that country. Such laws, known as blocking laws, prohibit “the disclosure, copying, inspection or removal” of documents located in the host country in compliance with orders of foreign authorities.<sup>72</sup> Blocking laws do not necessarily

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66. See *Powell*, 379 U.S. at 57–58.

67. *United States v. Morse*, 532 F.3d 1130, 1132 (11th Cir. 2008).

68. See *Sharp & Sheppard*, *supra* note 63, at 387. A different set of requirements governs requests to third-party record-keepers. I.R.C. § 7609(c)(1).

69. See I.R.C. § 7609(f); see generally Frank P. Cihlar, *Coming to America: The Extraterritorial Reach of U.S. Judicial Process*, 16 J. FINANCIAL CRIME 115, 117 (2009) (describing the history and legal context of the summons power).

70. *Id.* A John Doe summons must also not be overbroad. Courts typically enforce this requirement by determining whether the request was described in sufficient detail and specificity and whether it was relevant to the inquiry. See *United States v. Abrahams*, 905 F.2d 1276, 1285 (9th Cir. 1990), *overruled on other grounds by United States v. Jose*, 131 F.3d 1325, 1329 (9th Cir. 1997).

71. See *Sharp & Sheppard*, *supra* note 63, at 388.

72. RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 442 Reporters’ Note 4. For example, Swiss law prohibits production of documents or testimony before a foreign tribunal and provides general protection of business and commercial documents. See *Jones*, *supra* note 27, at 463–64.

act as a bar to enforcement of a U.S. tax summons.<sup>73</sup> If the summoned party faces the dilemma of complying with U.S. discovery and a foreign rule of nondisclosure, the court will determine which law applies by balancing the competing U.S. and foreign interests using principles of international comity. Under the Restatement Third's approach, the following five factors are weighed in the balance: (1) the importance to the investigation or litigation of the documents or other information requested; (2) the degree of specificity of the request; (3) whether the information originated in the U.S.; (4) the availability of alternative means of securing the information; and (5) the extent to which noncompliance with the request would undermine important interests of the United States, or compliance with the request would undermine important interests of the state where the information is located.<sup>74</sup>

U.S. courts have not uniformly compelled disclosure of information in the face of foreign blocking laws but have drawn certain principled distinctions in balancing the competing interests. The U.S. interest in maintaining the grand jury's power to investigate tax and narcotics violations has been found to outweigh the foreign state's interest in its bank secrecy laws.<sup>75</sup> Courts, however, have split on whether the U.S. interest in determining and collecting taxes and prosecuting tax fraud by its nationals outweighs a foreign government's interest in preserving the secrecy of business records.<sup>76</sup> In assessing the foreign interest, courts are likely to assign more relative weight if the blocking statute is absolute<sup>77</sup> and conversely will accord it less weight if the statute permits exceptions, such as for private parties' consent to disclosure.<sup>78</sup>

The more recent trend favors compelling disclosure. Whereas prior to the current version of the Restatement courts would consider the demonstration of good faith by the party resisting discovery as a factor in determining whether to issue the production order,<sup>79</sup> the current Restatement

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73. See JCT REPORT, *supra* note 50, at 44-45.

74. RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 442(1)(c) (1987).

75. See *United States v. Bank of Nova Scotia*, 691 F.2d 1384, 1391 (11th Cir. 1981) (citing *United States v. Field*, 532 F.2d 404 (5th Cir. 1976)).

76. Compare *United States v. Vetco*, 691 F.2d 1281 (9th Cir. 1981) (enforcing a grand jury subpoena for business records), with *United States v. First National Bank of Chicago*, 699 F.2d 341 (7th Cir. 1983) (declining to enforce an Internal Revenue Service summons directed to production of records maintained at the bank's Athens branch.). See also RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 442 Reporters' Note 7.

77. See *First National Bank of Chicago*, 699 F.2d at 345 (refusing to compel disclosure where foreign statute clearly provided that release of the summoned information, even with the consent of the depositor, would result in criminal punishment under the law).

78. See *Vetco*, 691 F.2d at 1289 (determining Switzerland's interest was diminished because the Swiss law at issue prohibited disclosure only if the party whose business secret is being divulged does not consent). The court additionally noted that the District Court expressed doubt that compliance with summons would violate Swiss law. See *id.* at 1288 n.7.

79. See *Linde v. Arab Bank, PLC*, 463 F.Supp.2d 310, 315 n.4 (E.D.N.Y. 2006); see, e.g., *Vetco*, 691 F.2d at 1288.

takes the position that the issue of good faith may affect whether the court sanctions a party for non-compliance with a production order.<sup>80</sup> One court reads the current Restatement as directing courts to consider good faith only for this latter, more narrow purpose.<sup>81</sup> Also undercutting the resisting party's interests in the current version is the Restatement authors' endorsement of the U.S. government position that persons who conduct business in the U.S. "are subject to the burdens as well as the benefits of U.S. law, including the laws on discovery."<sup>82</sup> The only circuit court case to apply the current version of this provision ordered a foreign party to comply with a discovery order, noting that "although courts should take care to demonstrate due respect for any special problem confronted by a foreign litigant on account of its nationality, a foreign national that chooses to engage in business in the United States likewise must demonstrate due respect for the operation of the U.S. judicial system."<sup>83</sup>

## B. Multilateral Tax Enforcement Measures

### 1. *U.S. Role in the OECD Initiative*

The U.S. commitment to the OECD Harmful Tax Competition initiative has fluctuated over the last two decades with the change of administrations. The Clinton Administration was influential in shaping the OECD's tax competition initiative.<sup>84</sup> Treasury Secretary Lawrence H. Summers considered the project's objective of identifying harmful tax regimes to be important "in preventing distortions that could undermine the benefits of enhanced capital mobility in today's global economy."<sup>85</sup> Summers appeared receptive to the idea that the OECD was establishing a standard on tax practices to which other countries should adhere.<sup>86</sup> The Bush Administration, however, opposed portions of the OECD's project to target tax havens.<sup>87</sup> The Bush Administration focused on language in the 1998 OECD report, which was critical of tax havens that drive their effective tax rates below rates in other countries.<sup>88</sup> Treasury Secretary Paul H. O'Neill remarked that he was "troubled by the notion that any country, or group of countries, should interfere in any other country's decisions about how to

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80. RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 442(2).

81. See *Linde*, 463 F.Supp.2d at 315 n.4.

82. See RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 442 Reporters' note 1 ("This section generally supports the United States position, subject, however, to the principle of reasonableness.").

83. *Quaak v. Klynveld Peat Marwick Goerdeler Bedrijfsrevisoren*, 361 F.3d 11, 22 (1st Cir. 2004).

84. See JACKSON, *supra* note 3, at 7.

85. Press Release, United States Department of the Treasury, Treasury Secretary Summers Welcomes OECD Report on Harmful Tax Competition Havens (Jun. 26, 2000), available at <http://www.ustreas.gov/press/releases/l5735.htm>.

86. See *id.*

87. See JACKSON, *supra* note 3, at 7.

88. *Id.*

structure its own tax system.”<sup>89</sup> As a result of the Bush Administration’s efforts, the OECD moved away from efforts that appeared to interfere with other nations’ internal tax policies, and instead focused on improving tax information exchange with OECD member countries.<sup>90</sup>

## 2. Tax Information Exchange

One of the ways the United States has attempted to combat offshore tax abuse is by entering into tax treaties or tax information exchange agreements (TIEAs) with foreign countries. A tax treaty typically has several purposes, including arranging for tax information exchange, establishing maximum rates of tax for certain types of income, protecting persons from double taxation, and resolving other tax issues.<sup>91</sup> A TIEA is solely for the purpose of information exchange and typically is reserved for countries with nominal or no taxes.<sup>92</sup> In both cases, the United States seeks to advance its tax enforcement efforts through a formal arrangement.<sup>93</sup> Currently, the United States has entered into nearly seventy bilateral tax treaties with other countries.<sup>94</sup>

The United States uses the U.S. Model Income Tax Convention as a starting point in treaty negotiations, and Article 26 of the treaty addresses tax information exchange.<sup>95</sup> Regarding the scope of obtainable information, the treaty obligates the Contracting States to exchange information that “may be relevant for carrying out the provisions of [the] Convention or of the domestic laws of the Contracting States concerning taxes of every kind . . . .”<sup>96</sup> The language in this provision incorporates the standard in the U.S. statute that authorizes the IRS to examine “any books, papers, records, or other data which may be relevant or material.”<sup>97</sup> The Supreme Court has interpreted the language “may be” liberally, as reflecting the Congressional intent to allow the IRS to obtain “items of even *potential* relevance to an ongoing investigation, without reference to its admissibility.”<sup>98</sup> The Treasury, however, has clarified that the request must be relatively

89. *What is the U.S. Position on Offshore Tax Havens? Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Governmental Affairs*, 107th Cong. 49 (2001) (statement of Paul H. O’Neill, Secretary of the U.S. Department of Treasury).

90. See JACKSON, *supra* note 3, at 7.

91. See *Offshore Tax Evasion: Stashing Cash Overseas: Hearing before the S. Comm. on Finance*, 110th Cong. 120 (2007) (testimony of John Harrington, Acting International Tax Counsel of the U.S. Department of Treasury).

92. See *id.*

93. See REPORT ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE, *supra* note 1, at 18.

94. See JACKSON, *supra* note 3, at 9.

95. 2006 U.S. Model Income Tax Convention art. 26, available at <http://www.ustreas.gov/offices/tax-policy/library/model006.pdf>; JACKSON, *supra* note 3, at 9.

96. 2006 U.S. Model Income Tax Convention art. 26, para. 1, available at <http://www.ustreas.gov/offices/tax-policy/library/model006.pdf>.

97. I.R.C. § 7602 (2006); see Department of the Treasury, United States Model Technical Explanation Accompanying United States Model Income Tax Convention of Nov. 15, 2006, art. 26, para. 1, available at <http://www.ustreas.gov/offices/tax-policy/library/TEMod006.pdf>.

98. *United States v. Arthur Young & Co.*, 465 U.S. 805, 814 (1984) (emphasis in original).

targeted.<sup>99</sup> The treaty also provides for protecting the confidentiality of the information that one state receives from the other, requiring the state receiving the information to disclose it only to persons, administrative bodies, and courts involved in tax administration.<sup>100</sup> Finally, the treaty allows a Contracting State to refuse to share information in certain limited circumstances, including where obtaining the information would conflict with that state's laws.<sup>101</sup>

The United States has signed more than twenty TIEAs, many with known tax havens.<sup>102</sup> TIEAs are a more recent creation than comprehensive tax treaties. After an influential 1981 report on tax evasion recommended that TIEAs could help close the gap left by the United States' reliance on double tax treaties with non-tax haven jurisdictions,<sup>103</sup> in 1983 Congress passed legislation authorizing the U.S. Treasury Department to negotiate bilateral or multilateral TIEAs with several countries in the Caribbean and Central America.<sup>104</sup> Few offshore tax havens entered into a TIEA or a tax treaty requiring the exchange of tax information with the United States until the Bush Administration Treasury Department made a concerted effort to obtain TIEAs with known tax havens; this resulted in the signing of more than a dozen such agreements.<sup>105</sup> Some countries may have signed TIEAs to avoid being labeled as an uncooperative tax haven by the OECD.<sup>106</sup>

Although the number of offshore jurisdictions that have entered TIEAs since 2000 is symbolically impressive, TIEAs impose several practical limitations on U.S. tax enforcement.<sup>107</sup> The majority of TIEAs apply only to criminal matters, which present difficult issues of evidence and are only a minor part of the revenues at stake.<sup>108</sup> In addition, these agreements sometimes impose an additional requirement that the activities that are the subject of the information request constitute crimes in both contracting states; in cases of tax evasion, this requirement is difficult to meet.<sup>109</sup> Fur-

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99. The language "may be" would not support a request in which a Contracting State simply asked for information regarding all bank accounts maintained by residents of that Contracting State in the other Contracting State, or even all accounts maintained by its residents with respect to a particular bank. See United States Model Technical Explanation, *supra* note 97, art. 26, para. 1.

100. *Id.* para. 2.

101. *Id.* para. 3. The treaty does not permit a party to refuse to exchange information on the grounds that the party does not need the information for its own taxation purposes or that the information is held by a bank or other financial institution. *Id.* paras. 4-5.

102. REPORT ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE, *supra* note 1, at 19.

103. See Steven A. Dean, *The Incomplete Global Market for Tax Information*, 49 B.C. L. REV. 605, 650 (2008).

104. REPORT ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE, *supra* note 1, at 19.

105. *Id.*

106. *Id.*

107. See GRAVELLE, *supra* note 43, at 20.

108. See *id.* at 19-20.

109. *Id.* (noting that the OECD model TIEA contains such a "dual criminality" requirement).

thermore, these agreements do not override bank secrecy laws.<sup>110</sup> Finally, and most significantly, TIEAs usually allow for information exchange upon request only, which requires the requesting party to identify the potential tax evaders in advance.<sup>111</sup> Thus, on-request information does not help the IRS discover and find tax evaders but merely corroborates existing evidence.<sup>112</sup> Although having TIEAs in place has been said to have a deterrent effect against the most serious tax evaders, evidence indicates that on-request information reporting will not make significant inroads on tax evasion.<sup>113</sup>

A further practical hurdle in utilizing the TIEAs is that sometimes the country receiving the request for information has little information of value.<sup>114</sup> If a jurisdiction's corporate laws require no identification of shareholders or directors, or little to no financial recordkeeping, it is unclear what information could be exchanged were the jurisdiction to enter an information exchange agreement.<sup>115</sup>

### 3. *Qualified Intermediary Program*

In addition to its efforts to obtain tax treaties or TIEAs with foreign governments, the United States relies on certain foreign financial institutions to enforce compliance with U.S. tax information reporting requirements when its customers' accounts receive U.S.-source reportable payments.<sup>116</sup> Pursuant to an agreement with the IRS, the foreign institutions, known as qualified intermediaries (QIs), assume certain documentation and withholding responsibilities in exchange for simplified information reporting for foreign account-holders and the ability to avoid disclosing proprietary account-holder information to a withholding agent that may be a competitor.<sup>117</sup> Under the QI Program, QIs need report only

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110. *Id.*

111. *Id.* For example, the Bahamas-U.S. TIEA "provides that requests for tax information must be in writing and contain specified details that include the name of the person, the type of information requested, the period for which the information is requested, the likely location of the information, the applicable U.S. federal tax law, whether the matter is criminal or civil in nature, and the reasons for believing that the requested information is 'foreseeably relevant or material' to U.S tax administration." See Sullivan, *supra* note 34, at 332.

112. See Sullivan, *supra* note 34 at 332.

113. See *id.* at 333. Sullivan reaches this conclusion by extrapolating from IRS compliance statistics. "When there is comprehensive information reporting (as in the case of U.S. dividends and interest), the compliance rate is 96 percent. That is analogous to automatic information exchange. When there is little or no information reporting, the compliance rate drops to 46 percent. That is analogous to reporting on request. Given that offshore investors are likely to be more prone to evasion than on-shore investors, and given that on-shore information reporting is likely to be more comprehensive than on-request international exchange, the offshore compliance rate when information exchange is on request can be expected to be lower than 46 percent." *Id.*

114. See GRAVELLE, *supra* note 43, at 20.

115. *Id.*

116. See generally Susan C. Morse, *Qualified Intermediary or Bust?*, 124 TAX NOTES 471, 471 (2009).

117. See *id.*; IRS, *Qualified Intermediary Frequently Asked Questions*, <http://www.irs.gov/businesses/international/article/0,,id=139238,00.html>.

pooled information on their foreign clients.<sup>118</sup> QIs must, however, reveal the identities of U.S. clients so that U.S. taxpayers receive the same treatment from foreign institutions on U.S. source dividend and interest income that they would receive if the income were paid to them by a U.S. financial institution.<sup>119</sup> In effect, the IRS “trusts foreign banks to certify the nationality of non-U.S. clients and their eligibility for reduced withholding or exemption.”<sup>120</sup> The IRS does exercise some oversight by requiring QIs to verify account-holder identities and submit audit reports to the IRS.<sup>121</sup>

Despite the benefits the QI program offers to the IRS by overcoming practical difficulties in administering the withholding tax regime, the UBS case demonstrates that disclosure obligations under the program are weak. The QI program, as it currently stands, does not explicitly obligate the QI to disclose the identity of its U.S. clients who are the beneficial owners of accounts that are in the name of a foreign corporation, trust, foundation, or other entity.<sup>122</sup> UBS, taking advantage of this loophole, helped U.S. clients set up sham entities domiciled in tax havens to retain U.S. clients who refused to either identify themselves or divest their accounts of U.S. securities as required under the QI agreement.<sup>123</sup> Then, for U.S. tax purposes, UBS claimed that the offshore accounts were owned by these sham entities and therefore not subject to the reporting requirements of the QI agreement with the US.<sup>124</sup>

### C. Recent Proposals to Address Individual Tax Evasion

Several proposals focus on the expansion of information reporting. One such set of proposals involves multilateral collaboration. The European Union (EU) currently has in place a tax savings directive that gives members an option of either information reporting on all income paid to foreign entities or withholding tax.<sup>125</sup> Were the United States to join the EU Directive, the United States would benefit by gaining access to third-party information reporting on foreign investments of U.S. citizens; the other parties in turn would benefit by receiving income paid to their nationals.<sup>126</sup> This option, or a broader multilateral treaty along the same lines, could recover substantial revenues lost to offshore tax evasion.<sup>127</sup> Another multilateral option for the United States would be to cooperate with the OECD and other G-20 countries to improve information exchange

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118. See Treas. Regs. § 1.1441-1(e)(5); Martin Sullivan, *Proposals to Fight Offshore Tax Evasion*, 123 TAX NOTES 264, 266 (2009).

119. Sullivan, *supra* note 118.

120. *Id.*

121. *Id.*

122. See JCT REPORT, *supra* note 50, at 34.

123. Declaration of Daniel Reeves, Ex Parte Petition for Leave to Serve John Do Summons at 13-14, No. 08-21864 (S.D. Fla. June 30, 2008) (quoting a UBS document).

124. *Id.* at 11.

125. See GRAVELLE, *supra* note 43, at 21, 28.

126. See *id.* at 28.

127. See *id.*

and to persuade tax havens to enter into exchanges based on the OECD model.

Expanding bilateral information reporting is another of the proposed options. Some suggest that the United States should adopt the revised model OECD TIEA.<sup>128</sup> In contrast to the U.S. model, the OECD model does not require suspicion of a crime other than tax evasion and overrides tax haven bank secrecy laws.<sup>129</sup> Additionally, the United States could induce non-tax havens to make agreements to exchange information, which would require collection of information on interest payments by banks and other financial institutions.<sup>130</sup> A more radical proposal would be to renegotiate existing treaties to provide for automatic information exchange.<sup>131</sup> Some commentators regard this as the only way to bring an end to tax evasion.

Another area of focus for reform is the QI program. Revisions to the QI program would potentially enable the United States to obtain a great deal of information about U.S. taxpayer incomes. One proposal is to require QIs to independently verify the ownership of foreign corporations and similar entities, which they must already do under anti-money-laundering rules.<sup>132</sup> QIs would also be required to report any foreign source income of U.S. taxpayers.<sup>133</sup> A further proposal is to require the QI to share information about foreign clients with U.S. treaty partners.<sup>134</sup> To strengthen the auditing of QIs, proposals include requiring QIs to notify the IRS of any material failure in oversight, improving the evaluation of the risk of U.S. taxpayers' circumvention of U.S. taxes, and requiring audit oversight by a U.S. auditor.<sup>135</sup> A final proposal is to close the loophole in the law that allows the QI to accept the shell corporation as the beneficial owner.<sup>136</sup>

A further group of proposals centers on increased enforcement. Noting that the IRS is understaffed, one scholar recommends that it be given more resources and also that it focus more of its attention on combating overseas tax abuses.<sup>137</sup> Another proposal is to extend the statute of limitations from three to six years for cases involving offshore jurisdictions.<sup>138</sup> This extension would compensate for the delays due to offshore secrecy laws that the United States often confronts in obtaining offshore financial

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128. *See id.*

129. *See id.* at 28-29.

130. *See id.* at 29.

131. *See id.* The proposed Stop Tax Haven Abuse Act, S. 506, 111th Cong. (2009), would allow countries with automatic information exchange to stay off the tax haven list.

132. *See* GRAVELLE, *supra* note 43, at 30.

133. *See id.*

134. *See id.*

135. *See id.*

136. *See id.*

137. *Offshore Tax Evasion: Stashing Cash Overseas: Hearing Before the S. Comm. on Finance*, 110th Cong. 39 (2007) (statement of Reuven S. Avi-Yonah) [hereinafter *Avi-Yonah Testimony*].

138. *See* GRAVELLE, *supra* note 43, at 31.

and beneficial ownership information on accounts.<sup>139</sup>

A final set of proposals involves a carrot-and-stick approach toward tax havens. Although many assume that the benefits of being a tax haven flow primarily to residents of the tax haven, some suggest that the benefits often flow primarily to professionals from wealthy countries who provide banking and legal services.<sup>140</sup> Trading on the assumption that the tax havens value the welfare of their own residents, the United States, other donor countries, and multilateral and regional organizations could incentivize tax havens to cooperate in information exchange by increasing foreign aid.<sup>141</sup> A complementary punishment for non-cooperation could include denial of the benefits of portfolio interest exemption.<sup>142</sup>

### III. Legal Analysis of the Enforceability of the John Doe Summons against UBS

#### A. The United States Can Establish a Prima Facie Case for Enforcement of the Summons

The summons the United States sought to enforce against UBS satisfies the threshold test of enforcement laid out in the four *Powell* factors.<sup>143</sup> In its investigation the United States sought to determine whether approximately 52,000 U.S. taxpayers whom UBS identified as having maintained “undeclared” financial accounts at UBS have properly reported those accounts and paid the income taxes for those accounts. Because the IRS is statutorily authorized “to [determine] the liability of any person for any internal revenue tax,” the IRS’ issuance of the summons to ensure compliance with U.S. internal revenue laws regarding foreign financial accounts represented a legitimate purpose.<sup>144</sup> Next, the summons seeks records that will reveal the identities of and disclose transactions by the U.S. taxpayers with undeclared accounts; this is not only relevant to determine the taxpayer’s compliance with U.S. tax laws, it is perhaps the only way for the United States to achieve this purpose.<sup>145</sup> Finally, the summoned information was in UBS’ control and not already in the possession of the IRS, and the IRS submitted a declaration by one of its agents that it had taken all the necessary administrative steps.<sup>146</sup>

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139. *Id.*

140. *Id.* at 29.

141. Avi-Yonah Testimony, *supra* note 137, at 43.

142. *Id.* at 43-44.

143. See *supra* text accompanying notes 65-67.

144. See I.R.C. § 7602(a)(2) (2006).

145. Declaration of Daniel Reeves, Ex Parte Petition for Leave to Serve John Doe Summons at 2, No. 08-21864 (S.D. Fla. June 30, 2008).

146. Memorandum of Law in Support of Petition to Enforce the “John Doe Summons” at 18, *United States v. UBS AG*, No. 09-20423 (S.D. Fla. June 30, 2009). A declaration to that effect from an IRS officer is sufficient to establish the *prima facie* elements under *Powell*. See *United States v. Morse*, 532 F.3d 1130, 1132 (11th Cir. 2008).

## B. The U.S.-Swiss Tax Treaty Does not Preempt the John Doe Summons

One of the arguments UBS and the Government of Switzerland raised against the enforcement of the summons was that the U.S.-Swiss tax treaty preempts the IRS's summons power.<sup>147</sup> This argument is neither supported by the text of the treaty nor the relevant case law. Accordingly, the treaty does not void the IRS's ability to obtain tax information from a party located in the U.S.

A treaty can only preempt U.S. legislation if the treaty is clearly inconsistent with that legislation and, in entering the treaty, the United States clearly intended the treaty to preempt the legislation.<sup>148</sup> An interpretation of a treaty should strive to read it to be consistent with legislation to the greatest possible extent.<sup>149</sup> The tax treaty provides that the competent authorities of the United States and Switzerland are to exchange information that is necessary for carrying out the provisions of the tax treaty or to prevent tax fraud or the like.<sup>150</sup> Under the treaty, the term "tax fraud" encompasses conduct consistent with definitions of tax fraud under the domestic laws of both the United States and Switzerland but does not include acts constituting tax evasion under U.S. law.<sup>151</sup> Thus, although the scope of taxpayer information obtainable under the treaty is narrower than under the John Doe statute, this is not an inconsistency between the

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147. Brief of UBS AG in Opposition to the Petition to Enforce the John Doe Summons at 28-30, *United States v. UBS AG* No. 09-20423 (S.D. Fla. Apr. 30, 2009) ("The history and text of that treaty leave little doubt that the United States understood that the rights it would enjoy under that treaty, to obtain information otherwise subject to Switzerland's financial privacy laws, could not be supplemented through broader and unilateral domestic discovery mechanisms"); Amicus Brief of Government of Switzerland at 11-13, *United States v. UBS AG* No. 09-20423 (S.D. Fla. Apr. 30, 2009) ("Enforcement of the summons therefore would undermine the implementation of the treaty and be contrary to international law.").

148. *Société Nationale Industrielle Aérospatiale v. U.S. District Court*, 482 U.S. 522, 539 (1987) (noting, in the context of whether the Hague Evidence Convention preempted the discovery mechanisms of the Federal Rules of Civil Procedure, that "[w]hile it is conceivable that the United States would enter into a treaty giving other signatories control over litigation instituted and pursued in American courts, a treaty intended to bring about such a curtailment of the rights given to all litigants by the federal rules would surely state its intention clearly and precisely identify crucial terms"); *Murray v. The Charming Betsy*, 6 U.S. (2 Cranch) 64 (1804) ("an act of Congress ought never to be construed to violate the law of nations if any other possible construction remains").

149. *United States v. Lee Yen Tai*, 185 U.S. 213, 221-22 (1902).

150. Convention for the Avoidance of Double Taxation with Respect to Taxes on Income art. 26(1), U.S.-Switz., Oct. 2, 1996 [hereinafter U.S.-Switz. Tax Convention], available at <http://www.irs.gov/pub/irs-trty/swiss.pdf>. The treaty uses the phrase "tax fraud or the like."

151. See Department of the Treasury, Technical Explanation of the Convention and Protocol between the United States and the Swiss Confederation of Oct. 2, 1996, para. 1, available at <http://www.ustreas.gov/offices/tax-policy/library/TEM006.pdf>. The Protocol to the Convention defines tax fraud as fraudulent conduct that causes or is intended to cause an illegal and substantial reduction in the amount of tax paid to a Contracting State. The Protocol also clarifies that tax fraud for purposes of the Convention closely tracks the Swiss concept of tax fraud, which exists if the taxpayer has falsified a document that the taxpayer uses or intends to use to justify the amount that the taxpayer has reported on its return. *Id.*

treaty and statute because the treaty operates as a separate state-to-state means for obtaining taxpayer information.

In determining whether the United States intended the treaty to preempt the IRS' summons power, the first and primary recourse for divining intent is the text of the treaty itself.<sup>152</sup> A treaty intended to preempt such an important administrative power would be expected to state this objective clearly on its face, given the consequences to each contracting state's tax authority of having to rely on the treaty as the exclusive means of obtaining tax information.<sup>153</sup> But the treaty is silent on the summons power and only restricts the contracting parties' use of administrative measures in the context of a treaty request.<sup>154</sup>

In addition, relevant legal precedent supports the interpretation of the information sharing article of the U.S.-Swiss tax treaty as an optional means of obtaining tax information. In *Vetco*, the Ninth Circuit rejected the argument that the U.S.-Swiss tax treaty preempted the IRS' power to summon documents from a party located in the United States: "There is nothing in the treaty barring the use of summonses by the IRS to gather information. The treaty does not state that its procedures for the exchange of information are intended to be exclusive."<sup>155</sup> The court further concluded that the treaty's legislative history did not indicate such an intention.<sup>156</sup>

UBS argued against relying on the holding in *Vetco* because *Vetco* was based on the 1951 treaty in force between Switzerland and the United States, and the legislative history of the 1996 treaty worked a substantial change in the meaning of the treaty.<sup>157</sup> As an initial matter, unless the language of the treaty is ambiguous, the history of the treaty, the content of negotiations concerning the treaty, and the practical construction adopted by the contracting parties are not controlling on the meaning of the treaty.<sup>158</sup> But even assuming there is an ambiguity in the treaty that requires resort to legislative history, the legislative history that UBS references does not support its argument that the treaty is the exclusive means

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152. The Supreme Court has held that "[t]he clear import of treaty language controls unless application of the words of the treaty according to their obvious meaning effects a result inconsistent with the intent or expectations of its signatories." *Sumitomo Shoji America, Inc. v. Avagliano*, 457 U.S. 176, 180 (1982) (citations omitted).

153. *Cf. Société Nationale Industrielle Aérospatiale*, 482 U.S. at 539. Stressing the need to consider the consequences of making the Hague Convention the exclusive means of gathering evidence abroad, the court noted, "[a]n interpretation of the Hague Convention as the exclusive means for obtaining evidence located abroad would effectively subject every American court hearing a case involving a national of a contracting state to the internal laws of that state." *Id.*

154. U.S.-Switz. Tax Convention, *supra* note 150, art. 26(3).

155. *See United States v. Vetco*, 691 F.2d 1281, 1286 (9th Cir. 1981).

156. *Id.*

157. Brief of UBS AG in Opposition to the Petition to Enforce the John Doe Summons at 30 n.14, *United States v. UBS AG*, No. 09-20423 (S.D. Fla. Apr. 30, 2009).

158. *See Kreimerman v. Casa Veerkamp, S.A. de C.V.*, 22 F.3d 634, 638 (5th Cir. 1994).

for obtaining taxpayer information.<sup>159</sup> In stating that “[u]nder the proposed treaty, information may be exchanged in connection with the enforcement of either country’s domestic law only in the case of tax fraud,”<sup>160</sup> the explanation clarifies the scope of information that may be exchanged pursuant to the treaty but does not speak to the scope of the treaty itself.<sup>161</sup> Moreover, the interpretive analysis in *Vetco* has been endorsed by the Supreme Court; the Court held that the Hague Evidence Convention does not preempt other methods of discovery previously employed by common-law courts, where it contains no explicit provision to that effect.<sup>162</sup> This further suggests that the IRS may ignore treaty procedures when it expects alternative measures to be more efficient.

### C. Principles of Comity Weigh in Favor of Enforcement of the Summons

The balance of the factors courts consider in deciding whether to exercise their power to compel production of protected documents and information weighed in favor of enforcement.<sup>163</sup>

The first factor, the importance to the investigation or litigation of the documents or other information requested, certainly weighed in favor of the United States. The success of the U.S. investigation into the thousands of taxpayers whom UBS aided in committing tax fraud and tax evasion depended on accessing the taxpayers’ identities.<sup>164</sup> Further, the information the IRS sought was not cumulative of information already produced, which would often cause courts to not require production.<sup>165</sup>

Second, the balance of interests favored the United States regarding the degree of specificity of the request. Notwithstanding that the United States sought taxpayer information pertaining to undeclared accounts, the United States drafted a sufficiently specific request on the basis of information it learned in its criminal prosecution of UBS.<sup>166</sup> A summons setting out the class of names in categorical terms is sufficiently specific to enforce

159. Brief of UBS AG in Opposition to the Petition to Enforce the John Doe Summons at 29–30, *United States v. UBS AG*, No. 09-20423 (S.D. Fla. Apr. 30, 2009).

160. STAFF OF J. COMM. ON TAXATION, 105TH CONG., EXPLANATION OF PROPOSED INCOME TAX TREATY AND PROPOSED PROTOCOL BETWEEN THE UNITED STATES AND THE SWISS CONFEDERATION 50 (J. Comm. Print 1997).

161. See *Kreimerman*, 22 F.3d at 640 n.34 (“it is common for treaty regimes to have mandatory language that tells signatories what they must do to execute particular provisions of the treaties. But again, such language tells us nothing about the scope of the treaties themselves.”).

162. See *Société Nationale Industrielle Aérospatiale v. U.S. District Court*, 482 U.S. 522, 539 (1987).

163. RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 442(1)(c) (1987).

164. See *Linde v. Arab Bank, PLC*, 463 F. Supp. 2d 310, 315 (E.D.N.Y. 2006) (enforcing summons where the discovery sought was essential to the proof of the plaintiffs’ case).

165. See *Vetco, Inc.*, 691 F.2d at 1290.

166. See Statement of Facts at 3, *United States v. Birkenfeld*, No. 08-CR-60099-ZLOCH (S.D. Fla. Jun. 10, 2008) (describing the accounts at issue).

a John Doe summons.<sup>167</sup> In the summons to UBS, the United States defined the John Doe class in technical terms and specified a date range of accounts.<sup>168</sup>

The third factor, whether the information originates in the United States weighed against requiring disclosure. If the requested information is located in a foreign country, this weighs against disclosure because the people who must produce the documents are subject to the law of that country in the ordinary course of business.<sup>169</sup> Here, the information originated and resides exclusively in Switzerland.<sup>170</sup>

Fourth, the United States did not have adequate alternative means of securing the information. The primary alternative channel to secure the information is the tax treaty between the two countries. In fact, the United States first attempted to obtain the taxpayer names from the Swiss government through the treaty in 2008 but was unsuccessful.<sup>171</sup> The United States anticipated this result because the treaty presented several obstacles to obtaining the names. First, the treaty requires the requesting party to specifically name the taxpayers whose information it seeks.<sup>172</sup> Second, as mentioned above, the tax treaty allows for information exchange in the case of affirmative tax fraud only, not tax evasion, and the United States suspected that many taxpayers under investigation did not commit acts amounting to tax fraud.<sup>173</sup> Finally, the U.S.-Switzerland treaty allowed

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167. See *United States v. Hayes*, 722 F.2d 723, 724 (11th Cir. 1984) (ordering a tax shelter promoter to comply with two John Doe summonses for documents located in Switzerland. The summonses sought the “partnership records” of Panamanian partnerships, which the promoter had established as part of the tax shelter scheme).

168. The class includes, “United States taxpayers who at any time during the years 2002–2007 had authority with respect to any financial accounts maintained at, monitored by, or managed through any office of UBS AG (or affiliate) in Switzerland, for whom UBS AG (1) did not have in its possession Forms W-9 executed by the U.S. taxpayer, and (2) had not filed timely and accurate Forms 1099 naming such U.S. taxpayers and reporting to United States taxing authorities all payments made to such U.S. taxpayers.” Memorandum of Law in Support of Petition to Enforce the “John Doe Summons” at 6, n.4, No. 09-20423 (S.D. Fla. June 30, 2009).

169. See *Richmark Corp. v. Timber Falling Consultants*, 959 F.2d 1468, 1475 (9th Cir. 1992); *Linde*, 463 F. Supp. 2d at 315 (“The only one of the factors that arguably favors recognition of the bank secrecy laws as a bar to discovery is the fact that the vast majority of the discovery sought here concerns information that originated outside of the United States.”).

170. See Brief of UBS AG in Opposition to the Petition to Enforce the John Doe Summons at 44–45, *United States v. UBS AG*, No. 09-20423 (S.D. Fla. Apr. 30, 2009).

171. See David S. Hilzenrath & Tomoeh Murakami Tse, *Deal Marks End of Era for Swiss Banking*, WASH. POST, Aug. 20, 2009, at A1.

172. See Technical Explanation of the Convention and Protocol between the United States and the Swiss Confederation, *supra* note 151, art. 26 para. 1. “The information to be exchanged is that which is necessary for carrying out the provisions of the Convention or for the prevention of tax fraud or the like in relation to the taxes covered by the Convention. The requirement that information be “necessary” to carry out these provisions, which also is contained in the OECD Model, consistently has been interpreted as requiring only that the information be “relevant” . . . . Accordingly, the result should not be different under the Convention than under the U.S. Model . . . .” *Id.*

173. See STAFF OF J. COMM. ON TAXATION, *supra* note 160, at 50; Declaration of Daniel Reeves, Ex Parte Petition for Leave to Serve John Doe Summons at 4, No. 08-21864 (S.D.

Switzerland to use its bank secrecy laws as a defense to supplying information.<sup>174</sup>

UBS argued that the IRS had received or could receive the information it sought through other means,<sup>175</sup> but its reasoning on this score was flawed. Although UBS pointed out that the IRS received information on UBS accounts involving offshore Swiss entities pursuant to the DPA, these approximately 200 to 300 accounts represent a small fraction of the total offshore business UBS facilitated.<sup>176</sup> Moreover, the accounts belonged to entities that authorities reasonably suspected had engaged in “tax fraud or the like.”<sup>177</sup> Assuming that this phrase was given its traditional Swiss legal interpretation, this group of accounts would have excluded taxpayers who merely failed to report assets and income.<sup>178</sup> Although UBS also argued that the voluntary disclosure program would be another means for the IRS to receive account information, UBS failed to consider that the success of the program in the end depended on taxpayers perceiving a risk that the U.S. court might force UBS to disclose additional names to the IRS.

Finally, the interest of the United States in requiring disclosure outweighs the Swiss interest in prohibiting disclosure. The United States undoubtedly has an important interest in enforcing its tax laws and, more specifically, in maintaining the integrity of its tax system in the face of the proliferation of foreign secret bank accounts used by Americans to evade income taxes.<sup>179</sup> Indeed, investigations conducted by several congressional committees<sup>180</sup> and recent proposed legislation<sup>181</sup> demonstrate the U.S. government’s concern with offshore tax evasion. Moreover, because this is a civil enforcement proceeding where the United States is the party moving to compel production, rather than merely a private civil suit, the court is entitled to “accord some deference to the determination of the Executive Branch—the arm of the government charged with primary responsibility for formulating and effectuating foreign policy—that the adverse diplomatic consequences of the discovery request would be out-

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Fla. June 30, 2008) (stating that the John Doe class is comprised of U.S. taxpayers who chose not to provide Forms W-9 to UBS identifying themselves as U.S. taxpayers).

174. Switzerland “expressly reserved with respect to paragraph 5 of Article 26 of the OECD Model Treaty (prohibiting a requested State from declining to supply information because that information is held by a bank, other financial institution, nominee or person acting in an agency or fiduciary capacity, or because it relates to ownership interests in a person).” JCT REPORT, *supra* note 50, at 52.

175. Brief of UBS AG in Opposition to the Petition to Enforce the John Doe Summons at 48, *United States v. UBS AG*, No. 09-20423 (S.D. Fla. Apr. 30, 2009).

176. See Hilzenrath & Tse, *supra* note 171 (stating that UBS provided the U.S. with information on 200–300 accounts); see also JCT REPORT, *supra* note 50, at 32 (observing that there may be as many as 52,000 offshore UBS accounts).

177. See U.S.-Switz. Tax Convention, *supra* note 150, art. 26(1).

178. See Lee Sheppard, *Justice Department Reacts to Disclosure Case*, 57 TAX NOTES INT’L 412, 413 (2010).

179. *United States v. Bank of Nova Scotia I*, 691 F.2d 1384, 1390–91 (11th Cir. 1982).

180. See REPORT ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE, *supra* note 1; JCT REPORT, *supra* note 50.

181. See Stop Tax Haven Abuse Act, S. 681, 110th Cong. (2007).

weighed by the benefits of disclosure.”<sup>182</sup>

The Swiss interest in maintaining its financial privacy laws, though substantial, should receive relatively less weight. The strength of the Swiss interest is expressed by three Swiss criminal statutes that prohibit disclosure of the information requested in the summons.<sup>183</sup> Moreover, the Swiss government demonstrated its strong interest in enforcing domestic financial privacy laws by filing of an amicus brief in the case.<sup>184</sup> Nevertheless, two considerations cut against the Swiss interest. First, Swiss financial privacy laws do not protect the Swiss government or some other public institution or interest directly; they merely protect the privacy of non-consenting private parties.<sup>185</sup> Second, as a party to a QI agreement with the United States, UBS was required to report the identity of its U.S. clients holding accounts in Switzerland. The summons does not infringe upon Swiss national interests to the extent that UBS was required to disclose the requested information under U.S. law.<sup>186</sup>

UBS also argued that its good faith attempt to comply with the summons is a further factor weighing against requiring disclosure,<sup>187</sup> but UBS erred in applying the good faith factor to the current proceeding. The current Restatement only directs courts to consider good faith when deciding whether to impose contempt sanctions or other penalties if a party fails to comply; good faith is irrelevant in an enforcement action like the UBS case.<sup>188</sup> Even conceding that courts may draw on the prior Restatement in order to make an holistic assessment of comity, that version inquires into the extent of hardship for the party objecting to enforcement of the summons, a factor that clearly favors enforcement. First, the hardship to UBS from complying with inconsistent laws is not certain because the bank secrecy laws do not act as an absolute bar to the disclosure of financial

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182. See *Minpeco, S.A. v. ContiCommodity Services, Inc.*, 116 F.R.D. 517, 523 (S.D.N.Y. 1987) (quotations omitted).

183. Brief of UBS AG in Opposition to the Petition to Enforce the John Doe Summons at 23, 40, *United States v. UBS AG*, No. 09-20423 (S.D. Fla. Apr. 30, 2009). “Article 47 of the Swiss Banking Law strictly prohibits the disclosure to third parties of information relating to Swiss bank accounts.” *Id.* at 16. “Article 271 of the Swiss Penal Code prohibits, except with the assistance of Swiss authorities, the collection of evidence on Swiss territory pursuant to the orders of a foreign court or performed by a party for the purpose of production in a foreign proceeding.” *Id.* at 17. “Article 273 of the Swiss Penal Code prohibits, among other things, the disclosure of ‘trade or business secrets.’” *Id.*

184. See RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 442, comment c (noting that expression of interest by the foreign state is one factor a court will consider in determining the national interests); *Minpeco, S.A.*, 116 F.R.D. at 525.

185. *United States v. Vetco, Inc.*, 691 F.2d 1281, 1289 (9th Cir. 1981); *Minpeco, S.A.*, 116 F.R.D. at 525.

186. See, e.g., *Minpeco, S.A.*, 116 F.R.D. at 525.

187. Brief of UBS AG in Opposition to the Petition to Enforce the John Doe Summons at 46–47, *United States v. UBS AG*, No. 09-20423 (S.D. Fla. Apr. 30, 2009). UBS argued it had made “substantial efforts” to comply with the summons, including conducting a wide-ranging search for information located in the United States, exiting the cross-border business, and encouraging its account-holders to voluntarily disclose to the IRS. *Id.* at 47.

188. See *supra* note 81 and accompanying text.

information. In *Vetco*, the court noted that where production of bank records is pursuant to an order of a U.S. court enforcing an IRS summons, Swiss law may provide a defense of duress to a charge of violating the law.<sup>189</sup> In addition, when a party could have avoided the prospect of being forced to comply with inconsistent laws, his hardship is not afforded great weight.<sup>190</sup> In *Vetco*, where U.S. law obligated the witness to keep copies of the records at issue, but his failure to do so, in part, impelled the IRS to issue a summons, the court considered his hardship to be greatly diminished.<sup>191</sup> Similarly, any hardship that UBS might face from complying with the court order is a hardship that it brought upon itself by knowingly violating U.S. tax laws, so its hardship should not weigh strongly in the balance. A final consideration bearing on the assessment of the extent of hardship is the status in the litigation of the party resisting discovery. That UBS was the target of a criminal investigation, not merely a neutral source of information or a non-party witness, further diminishes the weight of its hardship.<sup>192</sup>

#### IV. Assessment of the UBS Settlement and its Implications for Future Tax Enforcement

##### A. Overview of the Treaty Request

Before discussing the ways in which the treaty acted as a limitation on the IRS' ability to receive all the account information it originally demanded, it is necessary to clarify that the treaty request did not strictly adhere to the terms of the Swiss-U.S. tax treaty. The Swiss government agreed to interpret the term "tax fraud" broadly; whereas traditionally it covered only overt acts of concealment, in the treaty request it included failure to provide a W-9 disclosure form where the custody or bank account exceeded 1 million Swiss francs (US \$992,802) at any time from 2001 through 2008 and generated average annual revenue of more than 100,000 Swiss francs over three years.<sup>193</sup> For custody and bank accounts of clients engaged in "activities presumed to be fraudulent conduct," including using false documents, related entities, and nominees as conduits to repatriate assets and using calling cards to disguise the source of trading, the request reduced the disclosure threshold to 250,000 Swiss francs.<sup>194</sup> The request also subjected offshore company accounts to disclo-

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189. *Vetco*, 691 F.2d at 1289. The law at issue, Article 273, "provides, in pertinent part: 'Whoever makes available a manufacturing or business secret to a foreign governmental agency or a foreign organization or private enterprise or to an agent of any of them; shall be subject to imprisonment and in grave cases to imprisonment in a penitentiary. The imprisonment may be combined with a fine.' The term 'business secret' has been defined to include 'all facts of business life to the extent that there are interests worthy of protection in keeping them confidential.'" *Id.* at 1286-87 (citations omitted).

190. *Id.* at 1289-90.

191. *Id.*

192. See *Minpeco, S.A. v. ContiCommodity Services, Inc.*, 116 F.R.D. 517, 527 (S.D.N.Y. 1987).

193. See Annex, *supra* note 18, paras. 1(A), 2(A)(a).

194. *Id.* paras. 1(A), 2(A)(a).

sure if their assets exceeded 250,000 Swiss francs.<sup>195</sup>

In addition, the United States and Switzerland agreed to waive the requirement that a request for exchange of information provide clear identification of the persons concerned.<sup>196</sup> Instead, the parties agreed that the designated threshold levels of disclosure for different forms of tax fraud and tax evasion would satisfy this requirement.

## B. Disadvantages of Obtaining the Accounts through the U.S.-Swiss Tax Treaty

Given the extent to which the final agreement departed from the treaty, the treaty itself may seem merely a formality. But the way the IRS obtained the information will surely influence the way tax havens and their clients view tax treaties and other U.S. enforcement tools. By consenting to the use of a treaty request to obtain UBS clients' account information, the U.S. represented to the world that it is satisfied with the status quo of the OECD model tax treaty. The OECD standard for information exchange allows for information exchange only when the inquiring nation knows the identity of the suspected evader, and therefore it has limited value in the fight against offshore tax abuses.<sup>197</sup> During the UBS litigation, the United States and Switzerland were in the process of negotiations to revise their treaty to conform to the 2008 OECD standard, which the Swiss regarded as a major concession because it would expand the scope of allowable information exchange to information about individuals suspected of tax evasion.<sup>198</sup> Switzerland then used its offer to renegotiate the treaty as leverage in the UBS case, arguing in its communications with the U.S. Department of State that enforcing the summons would have interfered with the renegotiation of its tax treaty with the United States.<sup>199</sup> By succumbing to the Swiss position, the United States seems to have mistaken the appearance of cooperation on information exchange for meaningful cooperation.

As some commentators have pointed out, treaties should provide for automatic information exchange in order to most effectively combat off-

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195. *Id.* paras. 1(B), 2(B)(a).

196. *Id.* para. 1.

197. Protocol Amending the Convention for the Avoidance of Double Taxation with Respect to Taxes on Income art. 4 para. 10, U.S.-Switz., Sept. 23, 2009, available at <http://www.treas.gov/press/releases/docs/US-SwissProtocol.pdf>, (providing that the U.S. shall "provide the following information" to the Swiss authority when making a request: "information sufficient to identify the person under examination or investigation (typically, name and, to the extent known, address, account number or similar identifying information))." See also Martin A. Sullivan, *Switzerland, Guantanamo, and Tax Evasion*, 54 TAX NOTES INT'L 1068, 1069 (2009).

198. See Asher Rubinstein, *New Switzerland-U.S. Tax Treaty Further Erodes Bank Secrecy*, 55 TAX NOTES INT'L 34, 35 (2009); Sullivan, *supra* note 197, at 1069. Since the financial crisis, many formerly uncooperative tax havens have entered into treaties adhering to the OECD model. Randall Jackson, *Finance Ministers Call for Sanctions Against Uncooperative Tax Havens*, 54 TAX NOTES INT'L 1091, 1091 (2009).

199. See Amicus Brief of Government of Switzerland at 20, *United States v. UBS AG*, No. 09-20423 (S.D. Fla. April 30, 2009).

shore tax evasion.<sup>200</sup> The United States could have shown its commitment to automatic information exchange through continuing to press for enforcement of the John Doe summons, as the summons is in effect “a court-enforced equivalent of an automatic information exchange agreement.”<sup>201</sup>

The substance of the treaty request also presents problems. A primary criticism of the U.S. agreement to handle the case through a treaty request is that the number of accounts to be processed is far less than what the IRS initially sought to obtain.<sup>202</sup> In several ways, settling for a reduced number of accounts may undermine the IRS’ credibility in strictly enforcing U.S. tax laws. Most obvious is simply the IRS’ failure to fully achieve its objectives. Additionally, the IRS’ backing down from its original demand necessitated that it be selective in defining the scope of targeted accounts. Though the IRS appears to have handled this strategically by requesting accounts that involved “egregious behavior,” accounts that would be difficult for the IRS to identify, and accounts with high asset values,<sup>203</sup> the deal nevertheless may have left the public with the impression that the IRS is content to let some forms of offshore tax abuse go unpunished. This problem is particularly apparent in the case of clients who committed tax evasion, who are only being targeted if their account maintained high asset values during the relevant period. Restrictions like these show that the United States succumbed to the Swiss desire to preserve as much bank secrecy as possible.<sup>204</sup>

Finally, the agreement to work through the existing U.S.-Swiss tax treaty has several disadvantages from a procedural standpoint. Although the Swiss have set up a special task force to expedite the treaty request process,<sup>205</sup> the agreement provides that the Swiss government has one year to process the cases.<sup>206</sup> Under Swiss law, account-holders who are notified by UBS that their accounts meet the agreed criteria have the right to appeal the disclosure of their identity and account information.<sup>207</sup> Although the U.S. government initially predicted that the appeals would likely fail because the agreement targeted cases for which Swiss law would not preclude disclosure,<sup>208</sup> Senator Carl Levin expressed concern immediately fol-

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200. See, e.g., Sullivan, *supra* note 197, at 1068.

201. *Id.*

202. See, e.g., Stewart, *supra* note 26, at 589.

203. Stewart, *supra* note 19, at 563.

204. See Statement of Senator Carl Levin on Disclosure of Annex to the U.S.-Swiss Settlement Agreement in the UBS Case, November 17, 2009, available at <http://levin.senate.gov/newsroom/release.cfm?id=319992> (“the tortured wording and the many limitations in this Annex show[] the Swiss Government trying to preserve as much bank secrecy as it can for the future, while pushing to conceal the names of tens of thousands of suspected U.S. tax cheats”).

205. Stewart, *supra* note 26, at 587.

206. The Swiss agreed to process 500 cases within ninety days and the remainder within 360 days. UBS Agreement, *supra* note 15, art. 1(2).

207. See Sheppard, *supra* note 178, at 413.

208. See Stewart, *supra* note 26, at 588.

lowing the settlement about the prospect of drawn-out appeals.<sup>209</sup> On January 21, 2010, the Swiss Federal Administrative Court, ruling on an appeal by a U.S. account-holder objecting to the disclosure of account data, held that the Swiss government's expansive reading of the treaty "was invalid and that the taxpayer's mere failure to disclose income or to file a W-9 was not sufficient to breach bank secrecy under the information disclosure provisions of the 1996 Switzerland-U.S. income tax treaty."<sup>210</sup> The Swiss Federal Council, acknowledging that the court ruling put the August 19, 2009, agreement in jeopardy, first commenced diplomatic talks with the United States regarding its ability to comply with the agreement.<sup>211</sup> But after nearly a month of deliberations, the Swiss Federal Council announced that it would seek parliamentary approval for the agreement; until such approval, the Swiss will not transfer any client data to the IRS.<sup>212</sup> This latest development underscores that the significant drawback of the treaty process is that the fate of the settlement is largely in the hands of the Swiss government, and potentially Swiss voters in the event of a referendum.<sup>213</sup>

### C. Need for Follow-Up

An ultimate appraisal of the settlement in the John Doe summons enforcement action also must consider whether the IRS and DOJ will take necessary follow-up steps. First, now that the IRS voluntary disclosure program has ended, the government must carefully review the voluntary disclosures made under the program to ensure that they are complete and accurate. For example, wealthy individuals may have maintained both personal and business offshore accounts and maintained accounts in multiple offshore jurisdictions.<sup>214</sup> There is obviously potential for abuse of the program, which could jeopardize the program's success.<sup>215</sup>

Another way for the government to follow-up on the UBS disclosures is to prosecute a critical mass of the names it has obtained. A steady stream of cases would deter potential tax evaders from concealing assets in offshore accounts because they would perceive the risk that the government will prosecute them. By early fall of 2009, the government had secured six guilty pleas of individuals whose names it obtained from the settlement of

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209. *See id.* This point was noted by Senator Carl Levin in his muted reaction to the UBS settlement. *Id.*

210. David D. Stewart, *Swiss Parliament May Decide U.S. Disclosure Issue*, 57 TAX NOTES INT'L 411, 411 (2010).

211. *Id.* at 411-12. (also noting that "[a]ccording to the council, it could put the August 19 agreement to a vote in the parliament. If approved, the agreement would receive the same legal status as a treaty and its terms would supersede the current treaty.")

212. David D. Stewart, *Swiss Parliament to Consider UBS Deal*, 57 TAX NOTES INT'L 731, 731-32 (2010).

213. *See id.*

214. Lee A. Sheppard, *Now What? Dealing with the UBS Account Disclosures*, 55 TAX NOTES INT'L 700, 705 (2009).

215. In fact, a previous tax evasion compliance initiative involving credit cards has been reported to be extensively abused. *See id.*

the criminal investigation; the government promised to also go after U.S. banks who helped U.S. clients hide money offshore.<sup>216</sup> The government can also use the disclosures more indirectly to prepare and serve additional John Doe summonses on other foreign banks that offered tax evasion services in the U.S.

#### D. U.S. Offshore Tax Enforcement Going Forward

This final section predicts what the outcome of the UBS case means for future tax enforcement regarding offshore accounts. First, by backing down from its original position to demand enforcement of the summons, the IRS has called into question whether it will take a firm position on enforcement of a future summons or even attempt to use the summons tool at all. The Swiss have apparently concluded that the IRS will “refrain from unilateral information-gathering measures that infringe Switzerland’s sovereignty and rule of law.”<sup>217</sup> If this promise to renounce an often-necessary enforcement tool proves true, clearly it is problematic that the IRS has hamstrung itself in this manner.

Despite capitulating to the Swiss by agreeing to work through the treaty, the IRS was able to save face, to some extent, because of the several treaty modifications that allowed it to still obtain a fairly sizeable number of accounts. This raises the question of to what extent the UBS case should be seen as a model for future cases, given that the particular factual circumstances of the UBS case were to some extent unique. The extent and detail of UBS’s fraudulent scheme appears to be unprecedented. Furthermore, the United States has been assured by the Swiss government that it will “work with the U.S. on similar requests for disclosure involving other Swiss banks.”<sup>218</sup> But in regard to a treaty request with any other state, it is far from certain that that state would agree to relax the standards of specificity of the request as the Swiss did or to provide information beyond the scope of its own laws. A tax haven that felt it had already cooperated sufficiently by entering into an information exchange agreement might be unwilling to concede anything more.

A further feature of the UBS saga that may distinguish it from any future cases is the IRS’ use of the voluntary compliance program in conjunction with the Swiss disclosures. Many offshore account-holders found the offer of leniency to be worth taking; their participation generated significant valuable information for the IRS on the extent of offshore tax evasion. Nevertheless, the IRS’ need to rely on the voluntary disclosure program may suggest that the IRS felt the treaty request alone would not be sufficient to net the amount of information it wanted. Whether the IRS in a future tax enforcement matter could stake its success on this kind of pro-

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216. Kim Dixon, *More Tax Cases Versus Wealthy, U.S. Banks*, REUTERS, Sept. 26, 2009, <http://www.reuters.com/article/idUSTRE58P1VA20090926>.

217. See Hilzenrath & Tse, *supra* note 171, at A1 (quoting statement from the Swiss Embassy in Washington following the settlement).

218. *Id.*

gram is perhaps doubtful if the majority of those eligible have already come forward.

Finally, two positive developments for future tax enforcement that occurred in the wake of the UBS case are worth mentioning. As it prepared to receive the 4,450 UBS AG Swiss bank accounts, the IRS announced that it was “shifting audits of wealthy Americans suspected of offshore tax evasion to an . . . office within its Large and Mid-Size Business division that will be responsible for monitoring what it called the ‘global high-wealth industry.’”<sup>219</sup> “Responsibility for auditing wealthy individuals had formerly been split among IRS divisions devoted to small businesses and self-employed wage earners and investors.”<sup>220</sup> That task is now centralized in a sophisticated unit with “the most experience navigating international tax treaties and untangling complex cross-border business structures.”<sup>221</sup>

The other important development is the addition of the IRS Criminal Investigations Division to the Financial Fraud Enforcement Task Force. An executive order directs the task force to bring a wide array of financial fraud cases, especially cases related to the current economic crisis, accounting fraud, and money laundering.<sup>222</sup>

## Conclusion

The IRS had some reason to celebrate the settlement of the protracted UBS summons enforcement case. This was the first major IRS offshore banking enforcement action in years and the first against a major Swiss bank. Moreover, the amount of information on offshore tax evaders that the IRS is set to receive is unprecedented. At the time of settlement, the IRS expected it would receive information on 4,450 accounts of taxpayers who had hidden money offshore in a UBS account. It also expected more information to come from its voluntary disclosure program and even hoped that the Swiss would follow through on their promise to cooperate in the investigation of other Swiss banks found to be assisting tax evasion by U.S. residents. Finally, one cannot overlook the deterrent effect of the settlement, both on foreign banks who assist in creating offshore accounts and on U.S. citizens contemplating opening an undisclosed foreign account.

On the other hand, the agreement to receive the names through a treaty request and to dismiss the summons represented an unfortunate miscalculation by the United States. The law was on the side of the United States to compel enforcement of the summons. But the United States seems to have fallen for the Swiss bargaining chip—a promise to renegotiate

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219. Ryan Donmoyer, *IRS Corporate Audit Division Will Examine UBS Tax Evasion Cases*, BLOOMBERG, Sept. 1, 2009, <http://www.bloomberg.com/apps/news?pid=20601103&sid=AlwcvA9gW3dE>.

220. *Id.*

221. *Id.*

222. The task force replaces a similar task force created under President George W. Bush in 2002, the Corporate Fraud Task Force, in which the IRS was not included. *Compare* Exec. Order No. 13,519, 74 C.F.R. 222 (2009) *with* Exec. Order No. 13,271, 67 Fed. Reg. 46,091 (July 9, 2002).

the tax treaty between the two countries to include information exchange standards meeting the OECD model. The OECD standards, however, are useless in most cases of offshore tax evasion because of the specificity they demand. Thus, not only must the United States now cope with a treaty process that will yield fewer names than if the summons had been enforced, the United States will gain very little from the new treaty going forward. The delays in the treaty process resulting from the Swiss court ruling rejecting the August 2009 agreement make the bargain appear even less defensible.

Finally, even if the case represents progress in the effort to end bank secrecy abuses, this does not mean that the fight is over. The case exposed the extent to which foreign banks in bank secrecy jurisdictions have been routinely selling tax evasion services to Americans and other wealthy individuals around the world, underscoring that UBS is just one small part of the problem. To truly capitalize on the resolution of the UBS case, the IRS must expend the necessary resources to pursue all leads from the information it has received. Now that the IRS has taken an initial step in attacking large-scale offshore tax evasion, it is in a unique position to continue to demand information disclosure and the loosening of bank secrecy.