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Trends, Developments in DOJ Investigation of Foreign Banks

BIGSTOCK

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On March 30, 2015, the U.S. Department of Justice announced that it had entered into a non-prosecution agreement with Swiss bank BSI SA for aiding U.S. taxpayers to evade income taxes through unreported offshore accounts—the first resolution under the DOJ's Program for Swiss banks.[1] The Program, announced on Aug. 29, 2013, is an amnesty program for Swiss banks not already under DOJ investigation.[2] In exchange for disclosing certain information regarding all U.S. related accounts since 2008, cooperation, and payment of a penalty, a bank may qualify for a non-prosecution agreement. Following the Program's announcement, over 100 Swiss banks—nearly a third of all Swiss banks—registered to participate.

The Program for Swiss Banks is just one component of a broad campaign to recover evaded taxes on unreported offshore accounts. Following the groundbreaking UBS deferred prosecution agreement in 2009, the DOJ has warned of impending actions against banks in a number of countries. Since then, the DOJ has obtained settlements or convictions against six foreign banks, four from Switzerland.[3] The BSI non-prosecution agreement, however, may be a bellwether of an accelerating pace of investigations to come.

This article surveys three areas: (1) the scale of the DOJ's investigation, (2) law enforcement techniques that the DOJ has employed in regard to banks and offshore accounts, and (3) the potential next phases of the investigation, including other countries beyond Switzerland that may become its focus.

The Scale of DOJ's Investigation

The DOJ's incentives for pursuing foreign banks are compelling. Estimates of personal wealth concealed in offshore accounts, on a global basis, range from between $21 trillion and $32 trillion in 2010.[4] According to a 2012

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Senate report, "offshore tax schemes [are] responsible for lost tax revenues totaling an estimated $150 billion each year."[5]

Foreign banks are a favored target—a one-stop investigation to recover unpaid taxes on every unreported U.S. account at the bank. In the first six foreign bank resolutions, the banks paid an aggregate of nearly $4.1 billion.[6] Each bank's payment is added to the recoveries obtained from the individual account holders who actually owed the unpaid taxes, raising the prospect of at least some double recoveries. The DOJ also has extracted recoveries from third-party financial advisors who managed accounts, yielding a potential third round of recoveries.

The investigation of a bank often prompts accountholders, who may be concerned regarding discovery and prosecution, to voluntarily report offshore accounts and pay back-taxes. For example, after the DOJ first acknowledged its investigation of UBS in August 2008, the IRS experienced increased taxpayer interest in voluntary disclosure of previously unreported accounts. In March 2009, the IRS established the Offshore Voluntary Disclosure Program (OVDP), which enabled a taxpayer to request immunity from prosecution in exchange for complete disclosure and payment of taxes and penalties. By the time the first OVDP closed in October 2009, the IRS had received 15,000 disclosures resulting in the collection of $3.4 billion in back taxes, interest and penalties.[7] Due to continued interest, the IRS announced two additional OVDP programs, including the current one, which has no fixed expiry. Through May 2014, the IRS has received more than 45,000 OVDP filings resulting in payments totaling $6.5 billion.[8]

DOJ's Law Enforcement Techniques

U.S. authorities have invested in the critical currency to investigate foreign banks—information. Foreign bank secrecy laws had once represented a significant barrier to investigation. With the Foreign Account Tax Compliance Act (FATCA), the United States championed a new international standard mandating automatic sharing of offshore account information. But even before FATCA is fully implemented, U.S. authorities are seeking to pierce the traditional protection of bank secrecy laws and collect information on account holders, banks and advisors. They have done so by employing several law enforcement techniques.

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Whistle-blowers and informers. In 2007, a disgruntled former UBS employee provided U.S. investigators with information relating to UBS' cross-border business and offshore accounts. Bradley Birkenfeld revealed that UBS maintained unreported offshore accounts for 20,000 U.S. clients, who in the aggregate held approximately $20 billion of undisclosed assets.[9] Others similarly have revealed secret bank information—some to authorities, some to the press, others to public interest groups—for reasons including personal reward, to avoid or mitigate their own punishment, vengeance, or other reasons.

OVDP Database. In addition to financial recoveries, OVDP filings are generating information to further investigations. An OVDP filing requires complete disclosure relating to each offshore account, including: (1) the bank where the account was maintained; (2) names of bank representatives, outside advisors and intermediaries; (3) the source of funds in the account; and (4) where funds were transferred.[10] All of the information reported in the 45,000 (and growing) OVDP disclosures is being incorporated into an IRS "OVDP database," which can be used to advance investigations and identify new bank targets.

The DOJ can search the OVDP database to identify each account associated with a particular bank and seek to interview account holders, financial advisors and bank employees—perhaps without the bank even being aware of an investigation. In April 2013, for example, the Department of Justice, relying on evidence derived from the OVDP database, successfully petitioned a federal court to compel a third-party bank to produce information regarding Canadian Imperial Bank of Commerce FirstCaribbean International Bank (FCIB). In support of the petition, a federal investigator testified in an affidavit that a search of the OVDP database identified more than 129 taxpayers who had disclosed unreported accounts at FCIB, and that several had been interviewed about FCIB's practices.[11]

John Doe summons. If the IRS does not know the identity of the taxpayer suspected of fraud, the IRS may petition a federal court for authority to issue a John Doe summons to a third party, such as a bank. The IRS need only show that the criteria for identifying the taxpayer are reasonably clear, that there is a basis for suspecting a violation of tax laws, the bank has relevant information, and the information cannot be obtained elsewhere.[12] The DOJ does not need to prove the bank's culpability for a John Doe summons.

Banks cooperating with the Department of Justice. The banks that have resolved DOJ investigations through agreement or guilty plea have been required to produce information about offshore accounts and provide cooperation. The cooperating banks are disclosing not only information relating to the accounts they manage, but also the sources and recipients of funds deposited in and transferred out of the accounts. That information can lead investigators to other and successor banks.

One such successor bank was Wegelin & Co., at the time the oldest Swiss bank still in operation. With no U.S. offices, Wegelin thought it was beyond the reach of U.S. prosecution, and solicited U.S. clients of other banks identified as under investigation by the DOJ. The DOJ followed fund transfers from other banks to Wegelin. On Feb. 2, 2012, the DOJ announced the indictment of Wegelin, and seizure of its $16 million U.S. correspondent bank account—and almost immediately, there was little left of the bank to defend. The indictment caused a rush on depository accounts, employee defections, credit constriction and spiraling legal fees—and the seizure of its correspondent bank

account created a liquidity crisis. Founded in 1741, Wegelin had weathered storms, wars and economic calamities, but it could not survive criminal indictment. On Jan. 3, 2013, Wegelin entered a guilty plea, and closed its doors for the final time.[13]

The Program for Swiss Banks. Over 100 Swiss banks, nearly one-third of all Swiss banks, registered to participate in the DOJ Program for Swiss Banks. The Program is designed to dramatically increase the information in the DOJ's database. As Kathryn Keneally, then the head of the Justice Department's Tax Division, explained: "We expect to get from the Swiss banks a wealth of information that will lead us to the rest of the world, and that information will be fueling our investigations for some time into the future."[14] Under the Program, each Swiss bank must identify accounts active on or after August 2008 that had indicia of U.S. interest. For each account, the bank must disclose the dates opened and closed and highest monthly account balance since inception. For every closed account, the bank must identify each transfer in and out of the account since 2008, the date of transfer, and the financial institution that either sent or received funds. Any active accounts that are not reported by account holders must be closed within two years.

Potential Next Phases of Investigation

From the start, the DOJ has investigated foreign banks outside of Switzerland. It has struck deals with banks from Luxembourg and Israel, and publicly pursued investigations of banks from the Caribbean, India, Singapore and Lichtenstein, among other places. But the Program for Swiss Banks will both accelerate and spread investigations.

In the aggregate, Swiss banks are estimated to hold over $2 trillion in private international wealth—by far the highest country share in the world.[15] Since 2008, U.S. holders of undisclosed accounts have faced a choice—voluntarily report accounts or transfer funds to banks elsewhere, and since the fall of Wegelin, that has meant outside of Switzerland. The BSI agreement is a tipping point; a critical hurdle cleared and a process in place. As the DOJ stated in its press release, "BSI and other banks in the Swiss Bank Program are also providing detailed information to the department about transfers of money from Switzerland to other countries. The Tax Division and the IRS intend to follow that money to uncover additional tax evasion schemes."[16]

If U.S. authorities once might have been hesitant to prosecute foreign banks, that clearly is not the case now. The DOJ's willingness to aggressively investigate foreign banks over unreported offshore accounts is consistent with what appears to be a broader U.S., and perhaps global, trend in bank prosecutions. Credit Suisse's agreement to plead guilty to a felony and pay $2.6 billion in penalties for offshore account-related activities was virtually unprecedented—until it was eclipsed weeks later by BNP Paribas' guilty plea and $8.9 billion fine for violating trading sanctions against blacklisted countries.[17] Around the same time, Lloyds Banking Group entered into a deferred prosecution agreement with the DOJ and agreed to pay $86 million arising from manipulation of LIBOR, the latest in a string of banks to admit to culpability in that matter.[18]

State authorities, particularly the New York State Department of Financial Services (DFS) also are taking an increasingly active role in matters involving foreign banks. In the Credit Suisse matter, for example, the DFS demanded a $715 million penalty, firing of senior executives and the installment of an independent monitor that would report to the DFS. The DFS obtained similar sanctions on Bank Leumi, and also has demanded substantial punishments against banks that have violated federal law against trading with Iran and Sudan.

As the scope of investigations widens to include more countries, this is likely to create further challenges for financial institutions. It will become increasingly important for them to engage in early evaluation of their respective situations. Financial institutions should assess the risk of DOJ challenge, bearing in mind that the DOJ already may know about at least some undisclosed accounts. They should implement strategies as warranted to address and minimize such risks. As well, where appropriate, banks should understand the facts and records around their accounts, in order to be prepared for a government investigation and engage in effective remedial action.

1. See DOJ Release No. 15-387 (March 30, 2015).
2. Joint Statement Between the U.S. Department of Justice and the Swiss Federal Department of Finance, dated Aug. 29, 2013, available at http://www.justice.gov/tax/2013/Joint_Statement_and_Program.pdf.
3. The foreign financial institutions comprise UBS ($780 million), Wegelin & Co. ($74 million), Liechtensteinische Landesbank ($23.8 million), Credit Suisse ($2.6 billion), Bank Leumi ($400 million), and BSI ($211 million). Those figures include payments to New York State Department of Financial Services.
4. In 2007, the Organisation for Economic Co-operation and Development estimated the total at $5 to $7 trillion. In 2012, the Tax Justice Network estimated that offshore assets at the end of 2010 had reached between $21 and $32 trillion. See J. Henry, "The Price of Offshore Revisited," Tax Justice Network (July 2012), available at http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore_Revisited_120722.pdf.
5. See U.S. Senate Permanent Subcommittee on Investigations, Staff Report, Offshore Tax Evasion: The Effort to Collect Unpaid Taxes on Billions in Hidden Offshore Accounts, at 9 & fn.8 (Feb. 26, 2014).
6. See supra note 4.
7. IRS, "IRS Offshore Voluntary Disclosure Efforts produce $6.5 billion; 45,000 taxpayers participate," FS-2014-6 (June 2014).
8. Id.
9. *United States v. UBS*, No. 09-60033-CR-Cohn, (S.D. Fla. 2009), Deferred Prosecution Agreement & Exh. B (Information); *United States v. Birkenfeld*, No. 08-CR-60099-Zloch (S.D. Fla.), statement of facts accompanying guilty plea agreement, June 8, 2008.
10. See, e.g., Form IRS Form 14454.
11. See DOJ Release No. 13-488 (April 30, 2013); Declaration of R/A Cheryl Kiger in Support John Doe Summons, *Matter of Tax Liabilities of John Does*, No.13-1938 (TEH) (N.D.Cal.). See also *U.S. v. Fellman*, Indictment (S.D.N.Y. Dec. 19, 2012) (OVDP database identified taxpayers who held 371 unreported accounts at Zurcher Kantonalbank; some were interviewed, leading to indictment of bankers).
12. 26 U.S.C. §7609(f).
13. R. Wood, "FATCA Cliff: Tax Evasion Guilty Plea and Death For Oldest Swiss Bank," Forbes (Jan. 3, 2013).
14. D. Barrett, "U.S. Broadens Hunt for Tax Evaders," Wall St. J. (May 27, 2014); ABA Meeting: U.S. Believes Swiss Bank Program Will Reveal Accounts in Other Jurisdictions, Tax Notes Today, at 185-88 (Sept. 14, 2013).
15. See Deloitte Wealth Management Centre Ranking 2015 (22 percent of $9.2 trillion international assets under management).
16. See supra note 2.
17. DOJ Release No. 14-686 (June 30, 2014).
18. DOJ Release No. 14-786 (July 28, 2014).

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