The UBS Settlement:

An Excursion into Tax “Fishing Expeditions”
Abstract

This paper discusses the current efforts in offshore tax compliance. First, the paper begins with an overview of the general problem faced by U.S. Authorities trying to obtain tax information from abroad. Second, the paper discusses the UBS Settlement in detail. Third, the paper explains the intricacies of the case and its future implications. Fourth, the paper describes why the settlement itself is not enough to end offshore tax evasion in other tax secrecy jurisdictions. Fifth, the paper describes the advantages and disadvantages of current international tax compliance efforts. Last, the paper discusses further solutions to prevent offshore tax evasion.
I. Overview

It was once said that “the avoidance of taxes is the only intellectual pursuit that carries any reward.”\(^1\) Still, “taxes are a price we pay for civilization.”\(^2\) The difference between tax avoidance and tax evasion sometimes becomes blurred; \(^3\) tax avoidance is considered a patriotic duty while tax evasion clearly violates the law. Obviously, placing money in an offshore account and electing not to disclose it falls into the tax evasion category. Nonetheless, just because a taxpayer has money in another country’s bank does not mean that they are engaged in tax evasion. To avoid penalties, a U.S. taxpayer must indicate on form 10-40 if they have a foreign account of more than 10,000 dollars.\(^4\) Some taxpayers may have money in other countries for business-related traveling expenses, while others may be engaged in foreign investment. Tax evaders, on the other hand, purposefully do not identify foreign accounts to avoid the higher income taxes they would have to pay if their money was located in the U.S.

“Tax haven” countries remain a popular destination for foreign capital for the tax evader and the corporation with a foreign subsidiary. Although there is no formal definition for a tax haven, the United States Gordon Report\(^5\) has identified traits common to these countries: (1) low rate of tax; (2) secrecy or confidentiality to persons transacting business; (3) modern banking

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\(^1\) John Maynard Keynes

\(^2\) Oliver Wendell Holmes, Jr.

\(^3\) According to Judge Learned Hand “…a transaction, otherwise within an exception of tax law, does not lose its immunity, because it is actuated by the desire to avoid, or, if one chose, to evade, taxation.” Helvering v. Gregory, 69 F.2d 809, 810 (2nd Cir. Mar. 19, 1934). He continues, “[a]ny one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one’s taxes.” Id.

\(^4\) See generally IRS Form 1040.

facilities; (4) advanced communications network; (5) lack of currency controls; (6) self
promotion as a tax haven; and (7) favorable tax treaties.⁶

Recognizing the benefits of obtaining foreign deposits by offering bank secrecy and
nominal tax rates, these tax havens have continued to thrive. According to one 1999 estimate,
there are over 1 trillion U.S. dollars hidden in offshore accounts, resulting in 40-70 billion tax
dollars being evaded.⁷ Financial intermediaries have added further fuel to the fire by creating
sham transactions and other hidden foreign deposits by using personal investment corporations
(“PICs”) so a taxpayer can effectively place assets in other countries without having to report it
on IRS form 10-40.⁸ Since these PICs, which are essentially investment shells, are incorporated
in tax havens, the bank secrecy laws of the tax haven restrict the disclosure of the persons who
own the account, which in turn, allows the PIC’s owners to avoid detection.⁹ These PICs are
typically managed from offices and financial intermediaries located within the U.S.¹⁰ The Union
Bank of Switzerland (“UBS”) is a multinational financial institution that has capitalized on bank
secrecy. Accordingly, the U.S. government has affirmed that UBS employees were engaged in a
criminal conspiracy with U.S. taxpayers to evade paying taxes to the Internal Revenue Service
(“IRS”). After a lengthy criminal investigation, U.S. taxpayers, UBS bank employees, foreign
nationals and UBS itself were named as defendants. As a result, UBS signed a deferred
prosecution settlement agreement in exchange for 4,450 undisclosed American accountholders.

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⁶ Some of these countries include: The Cayman Islands, Switzerland, Lichtenstein, The Cook Islands, Jersey, The
Isle of Man. For a more complete list of tax secrecy jurisdictions, please visit
⁷ Minority & Majority Staff Report for Permanent Subcommittees on Investigations on Tax Abuses: The Enablers,
The Tools and Secrecy, August 1, 2006 p. 1 [hereinafter “The Enablers, The Tools and Secrecy”].
⁸ Minority Staff Report for Permanent Subcommittees on Investigations Hearing on Private Banking and Money
⁹ Id.
Activities, July 1997.
The IRS and the Department of Justice (“DOJ”) have been working hard to bring tax evasion to an end; excluding diplomacy little can be done directly to the tax haven. Instead, U.S. authorities have been aggressively targeting taxpayers electing not to disclose foreign accounts and the financial intermediaries who have helped to hide these taxpayers’ assets. Despite increasingly novel and aggressive tactics employed by U.S. authorities, little can be done to stop tax evasion without further worldwide cooperation by bringing these criminals to justice.

The Organization of Economic Cooperation and Development (“OECD”) is at the forefront of international tax compliance. The OECD has created a model convention of tax information sharing treaties where Double Taxation Agreements11 (“DTAs”) and Tax Information Exchange Agreements12 (“TIEAs”) are proposed and launched.13 Even though the model convention lacks worldwide, multilateral support, the main purpose of the convention is to improve “the process for resolving tax disputes.”14 While the UBS Settlement may be at the vanguard of tax information sharing because nations with bank secrecy laws typically do not allow for “fishing expeditions”,15 the strategy used on the Swiss will not be enough to open the

11 Double taxation treaties are comprehensive agreements between two states to prevent income or profits from being taxed twice. The major reason countries sign such agreements is to foster foreign investment. Typically, inside article 26 of these treaties, the countries in agreement will allow for an exchange of tax information by a requesting country. See Infra TJN Briefing.

12 Tax Information Exchange Agreements are bilateral agreements which foster the exchange of tax information. Unlike the double taxation treaties, these agreements are for smaller, tax secrecy nations which do not typically engage in foreign investment. Also, these nations would not benefit from having double taxation treaties because they have low or no taxes on income or profits. The bulk of these agreements were signed as a result of pressure from the OECD after the Harmful Tax Practices Project of 2002 was initiated. See Infra TJN Briefing.


14 The Organisation of Economic Co-operation and Development, http://www.oecd.org/document/38/0,3343,en_2649_33767_43777958_1_1_1_1,00.html (last visited on Oct. 19, 2009).

15 By analogy, the term “fishing expedition” is used to describe actions of the IRS to locate information not readily available on delinquent tax-payers. Since “Congress has given the IRS broad powers to investigate “all persons who may be liable for federal taxes,” [the IRS may] obtain items of even potential relevance to any ongoing investigation, without reference to its admissibility.” Thomas v. U.S., 1996 WL 679495 (D. Or. Sept. 17, 1996).
doors to unrestricted mutual exchange of tax information. However, the threat of further prosecution of foreign banks may trigger increased compliance.

First, this paper analyzes the background of the UBS Settlement and its implications for gaining undisclosed taxpayer information from a tax secrecy jurisdiction. Next, this paper discusses why the UBS Settlement will not be enough by itself to end cross border tax evasion. Last, this paper proposes further solutions to prevent tax evasion.

II. The UBS Settlement: an illustration of the Leverage Needed to Get Tax Information on Unidentified Accountholders

A. Background of the UBS Settlement

In its aggressive pursuit of tax evasion, the IRS has done the unprecedented when they were able to get the UBS Settlement. Under the agreement, the IRS will dismiss its “John Doe Summons” (“the Summons”) in exchange for the names of U.S. taxpayers they believe have failed to disclose their offshore accounts in Switzerland. The IRS was able to get this agreement because they used a typical law enforcement method of “finding the bigger fish to fry.”

UBS is a well-to do international bank based in Switzerland. Like other foreign banks, UBS recognized the advantages of the IRS’s Qualified Intermediary (“QI”) program. Before becoming a QI, UBS was required to make U.S. tax withholdings on all income earned from U.S. securities regardless of whether the person was a U.S. citizen or not. So by becoming a QI, UBS would be allowed to limit or forgo these withholdings for their non-U.S. taxpayer

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17 The Matter of the Tax Liabilities of, U.S. District Court for the Southern District of Florida, Case No. 08-21864-MC-Lenard/Garber, Memorandum in Support of Ex Parte Petition to Leave to Serve “John Doe Summons,” Pg.3 (June 30, 2008) [hereinafter “the Memo in Support”].
18 Id.
clients. In exchange for the status, UBS would be required to maintain IRS form W-8BEN for non-U.S. taxpayers and W-9 for U.S. taxpayers.\textsuperscript{19} In addition, the QI status required UBS to inspect their clients by checking formal identification, citizenship paperwork and residency requirements.\textsuperscript{20} Also under the QI program, UBS was required to prepare and file form 1099, which reported U.S. investment income—dividends, capital gains, and interest.\textsuperscript{21} When a U.S. taxpayer refused to file the documentation, however, UBS was required to withhold twenty-eight percent on all U.S. source income.\textsuperscript{22} Thus, the QI agreement “was intended to mark a significant departure from the historically strict financial secrecy laws enjoyed by U.S. taxpayers with Swiss accounts, which often resulted in concealing otherwise taxable income to the IRS.”\textsuperscript{23}

At one time, a tax secrecy jurisdiction would not allow “fishing expeditions,” even when a tax information sharing treaty was in place. However, the circumstances surrounding UBS’s misconduct has been a different case entirely. On December 12, 2007, Mr. Olenicoff pled guilty under a plea agreement, and as a condition, he was required to cooperate with U.S. authorities. According to Mr. Olenicoff, he had used different organizations, including Barclays and UBS, to send money from his accounts in the U.S. to other countries and eventually to UBS accounts he had in Switzerland. He elected to answer “NO” to possessing foreign accounts which he was signatory to.\textsuperscript{24} According to court documents, Mr. Olenicoff was aided by UBS employee Bradley Birkenfeld to hide 200 million dollars in assets resulting in 7.2 million dollars in taxes being evaded.\textsuperscript{25} Birkenfeld was indicted for his involvement and he agreed to cooperate with

\textsuperscript{19} Id. at Pg. 4.
\textsuperscript{21} 1 Casey Fed. Tax Prac. §3:30:50
\textsuperscript{22} Treas. Reg. §1.1441-1(e)(5)(iii) (2007).
\textsuperscript{23} The Memo in Support at Pg. 3.
\textsuperscript{24} 26 U.S.C. 7206(1) (requiring a taxpayer to certify documents which they believe to be true under the penalty of perjury).
\textsuperscript{25} The Memo in Support at Pg. 5.
authorities in exchange for a plea agreement. Birkenfeld’s testimony stated that UBS personnel, instead of keeping proper forms as required by the QI agreement, would treat U.S. taxpayers as if they were non-U.S. taxpayers and therefore, would prepare and file the IRS form 8-WBEN in lieu of the W-9. Also, the testimony revealed that bank employees from Switzerland would come to the U.S. to market Swiss bank secrecy to wealthy, U.S. clients for them to evade U.S. taxes. According to Birkenfeld’s estimate, some 20 billion dollars of unaccounted for assets were offshore in UBS accounts that belonged to some 20,000 U.S. taxpayers.

On June 30, 2008, the DOJ obtained an ex parte leave to serve a John Doe Summons by the Southern District Court of Florida on UBS. Under section 7609 of the Internal Revenue Code, the Secretary of the Treasury is authorized to summon records for the purpose of inquiring after “persons who may be liable to pay any internal revenue tax.”

Under 7609(f), [a]ny summons…which does not identify the person with respect to whose liability the summons is issued may be served only after a court proceeding in which the Secretary establishes that:

(1) 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 a 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 examination of records or testimony (and the identity if the person or persons with respect to whose liability the summons is issued) is not readily available from other sources.

26 U.S.C. §7609(f)

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26 Id.
27 Id.
First, the summons related to an ascertainable class of persons because UBS had separated accountholders into either (1) those who filed the W-9 forms or (2) those who chose to remain undisclosed. Therefore, the undisclosed persons were ascertainable.\(^{31}\) Second, there was a *reasonable basis\(^ {32}\) for the belief that this group was failing to comply with the provision of the Internal Revenue Code because money transfers between the U.S. and Switzerland have been “inherently reasonably suggestive of tax avoidance” because of the Swiss’s “widely known reputation for protecting the identity of [its] accountholders.”\(^ {33}\)

Last, since the undisclosed accounts were located in Switzerland, the information sought for examination was not readily available because the two sources of international relief, the Mutual Legal Assistance Treaty (“MLAT”) and the Double Taxation Treaty with Respect to Taxes of Income (“The Swiss Treaty” or “The Double Taxation Treaty”), were not typically viable sources.\(^ {34}\) Under the MLAT between the U.S. and Switzerland, the Swiss would typically exchange information under specific criminal charges of persons whose identity was readily known. Since the purpose of the Summons was for a civil matter and the exact identities of the persons were unknown, an MLAT treaty request would not have been the best alternative. Under The Swiss Treaty, the specific requests for information will typically only be granted when the identity of the taxpayers are identified. Since UBS had been maintaining the accounts in such a manner the IRS could not learn the undisclosed accountholder’s identity, the use of the Summons was the only way to ascertain that information.\(^ {35}\)

\(^{31}\) The Memo in Support at Pg. 8.

\(^{32}\) The memo cites other cases where there was a *reasonable basis*: United States v. Pittsburgh Trade Exchange, Inc., 644 F.2d 302, 306 (3d Cir. 1981) (ruling the reasonable basis test had been met when barter transactions of the type arranged by the Pittsburgh Exchange were “inherently susceptible to tax error”); United States v. Ritchie, 15 F.3d 592, 601 (6th Cir. 1994) (holding there was a reasonable basis when legal services were being paid by large sums of cash).

\(^{33}\) Id. at Pgs. 9-12.

\(^{34}\) The Memo in Support at Pgs. 12-14.

\(^{35}\) Id.
After the petition for the Summons was granted and after the appeal that followed was denied,\textsuperscript{36} UBS and the U.S. Authorities signed a deferred prosecution agreement where the Summons will not be issued on UBS. Originally, the U.S. was asking the Swiss to produce roughly 52,000 names.\textsuperscript{37} However, under the agreement they negotiated, the U.S. Authorities will not seek criminal prosecution of UBS in exchange for approximately 4,450 names of persons they believed failed to comply with the Internal Revenue Code.\textsuperscript{38} To help comply with the treaty request, the agreement states that the Swiss Confederation should establish a special task force enabling the Swiss Federal Tax Administration (“SFTA”) to make final decisions on the names to disclose. The agreement further states that the first 500 decisions of SFTA must be fulfilled within 90 days and the balance of the 4,450 must be fulfilled within 360 days of the treaty request.\textsuperscript{39}

The Swiss have been working hard to come to an acceptable conclusion to the matter. Since the agreement, they appointed Hans-Jörg Müllhaupt to head the special task force whereby thirty audit firms, forty lawyers and other tax specialists will aid in the exchange of the names.\textsuperscript{40} Further, the agreement between the U.S. and Swiss governments even expands additional treaty requests if “they are based on a pattern of facts and circumstances that are equivalent to those of the UBS AG case.”\textsuperscript{41} What makes up “equivalent facts and circumstances” remains to be seen; even so, none of the 4,450 names have been produced….

\textsuperscript{39} Id.
B. The UBS Settlement’s Application Towards Furthering Tax Information Sharing

It is hard to imagine that UBS executives ever believed that Swiss bank secrecy laws would ever be in jeopardy when they became a QI. Indeed, the agreement may have increased UBS’s presence in the American Market, increased its profit share, and increased its exposure to American laws. Undeniably, the novel and aggressive strategy employed by U.S. Authorities shows the dedication and the complexity in receiving tax information through a tax information treaty request—case in point, the deferred prosecution agreement. As Senior Trial Attorney Kevin Downing stated, “[The UBS Settlement is] the beginning of this process, not the end.” So, the deferred prosecution agreement has opened the proverbial “can of worms” because it has shown other tax havens the American government will seek cooperation through the threat of prosecution. In summary, the U.S. gained leverage over the tax evaders hiding their money in Switzerland because of three reasons: (1) the breach of the QI agreement produced greater willingness on behalf of the IRS to prosecute UBS’s wrongdoing; (2) given that UBS’s insiders became willing to disclose offshore misconduct, the IRS had a reasonable basis to believe there was an ascertainable class of individuals who did not account for their offshore accounts; and (3) the treaties, to which the Swiss and U.S. are parties to could no longer prevent tax evaders from hiding behind Swiss bank secrecy laws.

1. U.S. Authorities’ Willingness to Pursue Wrongdoing

UBS’s strategy to solicit wealthy persons to engage in tax evasion increased its gross profits, but also increased its scrutiny to U.S. authorities. Indeed, the QI agreement helped to shelter UBS’s misconduct. But, having a QI status as a foreign bank is a privilege and it does come at a price. Initially, the IRS only allowed foreign financial institutions to apply for the QI

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42 Downing, Kevin, Depart. of Justic. Keynote address at The American Bar Association Fall Meeting (Sept. 2009).
status if there was a tax information sharing agreement in place between the U.S. and the jurisdiction to which the financial institution is located.\textsuperscript{43} However, the IRS subsequently decided to expand the QI program to include jurisdictions with proper “Know-Your-Customer”\textsuperscript{44} (“KYC”) rules because the status itself creates a self-regulation regime.\textsuperscript{45}

In exchange for simplified information reporting duties and the ability not to disclose proprietary accountholder information, the QI agrees to assume certain documentation and withholding responsibilities.\textsuperscript{46} For example, if a payment of U.S. source income from securities exists and it is reportable on form 1099 because there is no exception, then the QI must receive a W-9 from the taxpayer.\textsuperscript{47} If a foreign bank that is a party to a QI agreement (1) knows that an account holder is a U.S. taxpayer who should be providing documentation, and (2) the foreign banks is prohibited by law from disclosing the account holder, then the foreign bank must request from the account holder the authority to disclose his identity or exclude U.S. securities from his account.\textsuperscript{48} Essentially, if the accountholder does not document their status, the QI would be required to withhold U.S. source payments.\textsuperscript{49} Although each jurisdiction has different KYC rules, the foreign bank must have minimal policies and procedures for gathering accountholder information.\textsuperscript{50} Also, the IRS is not allowed to do external audits of the QI under the agreement; rather, an outsider will perform the task.\textsuperscript{51} However, the IRS may require the outsider to make

\textsuperscript{43} 1 Casey Fed. Tax Prac. §3:30.50
\textsuperscript{44} KYC rules may vary between jurisdictions. Essentially, the foreign banks must have policies and procedures in place for opening accounts, keeping records, verifying identities, etc. See Generally Rev. Proc. 2000-12, 2000-4 I.R.B. 387, Sec. 3.02(9).
\textsuperscript{45} See Announcement 2000-48.
\textsuperscript{46} Qualified Intermediary FAQs at Section 1: Becoming a QI, Answer 1, please visit http://www.irs.gov/businesses/international/article/0,,id=139238,00.html (last visited Oct. 12, 2009).
\textsuperscript{47} See Rev. 2000-12, 2000-4 I.R.B. 387, Sec. 2.
\textsuperscript{48} The Matter of the Tax Liabilities of:, U.S. District Court for the Southern District of Florida, Case No. 08-21864-MC-Lenard/Garber, Declaration of Daniel Reeves Pg. 3 (June 26, 2008) [hereinafter “The Shott Declaration”].
\textsuperscript{49} Id.
\textsuperscript{51} Rev. Proc. 2000-12, 2000-4 I.R.B. 387, Sec. 10.01.
further inquiries into the QI if findings become questionable.\textsuperscript{52} A default of the QI agreement will result in the termination of the agreement.\textsuperscript{53} If the QI loses its status, then it will have to account for the U.S. source income for both U.S. and Non-U.S. taxpayers as it did before the agreement.\textsuperscript{54}

By in large, the QI program itself has been a success. Instead of bullying foreign institutions into revealing information against the rule of their internal law, it allows for cooperation of withholding duties so the U.S. may receive some tax revenue. Of course, violating the agreement will result in stricter IRS scrutiny, such as “imposing increased or more rigorous audit requirements or stricter enforcement standards on businesses operating in such jurisdictions.”\textsuperscript{55} Thus, the QI agreement itself becomes a double-edge sword. If the entity continues to cooperate, they will enjoy the benefits of lower reporting duties. But, if there is a breach, then the entity will not enjoy the wrath of the U.S. Government.

UBS opened itself up to stricter scrutiny by IRS auditors because they breached their QI agreement. They breached the agreement because did not withhold U.S. source payments of undisclosed accountholders. Before the QI agreement was breached, only outsiders were allowed to audit the financial records of UBS. Since UBS intentionally manipulated the tax records of its undisclosed accountholders to look as though they were non-U.S. accountholders, the outside auditors would not have been able to tell the difference on paper between the U.S. taxpayers who elected to disclose their offshore accounts and those who did not. After the QI was breached, UBS now became required to disclose both its U.S. accountholders and non-U.S. accountholders because a foreign branch is required to disclose all U.S. source income from securities regardless

\textsuperscript{52} Rev. Proc. 2000-12, 2000-4 I.R.B. 387, Sec. 10.06.
\textsuperscript{53} Rev. Proc. 2000-12, 2000-4 I.R.B. 387, Sec. 11.02.
\textsuperscript{54} See Announcement 2000-48.
\textsuperscript{55} Id.
of whether the person was a citizen or not. UBS could no longer hide behind the QI agreement because the IRS has the long arm of the law and the “John Doe Summons.”

Again, the QI status is a privilege; it creates self-regulation standards and helps to ease reporting requirements. But even if a bank elects not to become a QI, the U.S. government will still likely assert jurisdiction even though there has been no contact between the U.S. and any bank employee.\(^\text{56}\) For example, the U.S. Attorney’s office in the past has prosecuted foreign nationals under the Foreign Corrupt Practices Act\(^\text{57}\) based simply on corrupt money passing through a New York bank.\(^\text{58}\) There is no doubt that bankers and wealthy clients who conspire to evade income taxes are guilty of the crime of conspiracy. Obviously, given the fact the conspiracy took place overseas will not deter law enforcement from prosecuting the crime.\(^\text{59}\) As a result, the future prosecution of banks, bankers, and tax evaders will continue regardless of whether the foreign bank is a QI or not. Thus, the fear of prosecution will create future compliance with the QI program.

2. UBS’s Insiders Became “Willing” to Disclose Offshore Misconduct

There are so many examples of people becoming witnesses for prosecutors. Examples range from mafia hit man turning on their bosses to a Liechtensteiner bank employee cooperating with authorities in exchange for 7.3 million Euros.\(^\text{60}\) No matter the example, the premise remains the same: if you want to catch the bigger fish, then you must entice the smaller ones. To entice the smaller ones, they need to become willing to disclose misconduct. So, the best way to receive cooperation under a treaty request is to get “snitches” to prosecute other foreign banks.

\(^\text{58}\) The Long Arm.
\(^\text{59}\) Id.
\(^\text{60}\) Senator Carl Levin, Key Note Address at the Conference on Increasing Transparency in Global Finance: A Development Imperative [hereinafter “Cong Docs”].
Specifically, the use of the John Doe Summons on UBS resulted after the IRS was able to get enough information from cooperating witnesses. This information allowed the first prong of section 7609(f) to be met in the UBS matter because Birkenfeld stated that UBS was keeping account holders in separate piles marked undisclosed and disclosed. By having this undisclosed category, the IRS had an ascertainable group of individuals that needed to account for their income on form 10-40. Thus, if the IRS can get cooperating witnesses from other foreign banks who are engaged in tax evasion conspiracies, they may be able to issue further “John Doe Summons” because the second and third parts of section 7609(f) may be met nearly by default after the UBS matter.

In particular, there was a reasonable basis for the belief that persons were evading income taxes because the Swiss have a “widely known reputation for protecting the identity of [their] account holders.” So, invariably U.S. Authorities will use the UBS precedent in future John Doe Summons’ requests by stating that “Singapore or the Cayman Isles are ‘widely known … for protecting the identity of [their] account holders.’” Therefore, making the second part of section 7609(f) met nearly by default.

Also, the third part of section 7609(f) may be met in further investigations because the information will not be readily available. In particular, tax havens have bank secrecy laws and they do not typically disclose the account holder’s information through a treaty request without the person being readily identifiable. The only place the IRS will be able to learn the identity of the person is through the financial intermediaries engaged in tax evasion. Therefore, U.S. Authorities can argue the third prong of section 7609(f) can best be met through a John Doe Summons’ Request and making the standard met nearly by default.
And the further use of the John Doe Summons will open the doors to criminal litigation. If a court allows an *ex parte* leave to grant a summons, the IRS will be allowed to audit all the tax records the financial intermediaries are keeping. As a result, the undisclosed accountholders should receive indictments from U.S. Authorities. In the case at bar, UBS quickly took a deferred prosecution agreement after clients and employees began to unravel the schemes the company’s personnel were undertaking. A civilized country such as Switzerland cannot overlook criminal actions of its citizens and businesses in other countries and be a party to treaties expressing objections to such behavior. By having witnesses to criminal conduct, U.S. authorities can continue to make treaty requests under MLAT, under the Swiss Treaty, or under the newly agreed to U.S.-Swiss declaration, if the facts and circumstances are equivalent. Switzerland will nevertheless be obligated to fulfill such requests because they cannot continue to uphold international cooperation when its citizens are engaging in criminal conduct in other countries.

3. **U.S.-Swiss Bilateral Treaties in Force**

Conventions between nations can add opportunities for growth and greater duties to one another. The Double Taxation Treaty is one such series of bilateral treaties that several OECD countries signed with one another. This series of treaties was promulgated to allow foreign persons the ability to engage in business in a foreign jurisdiction without the obstacle of paying taxes to both the jurisdiction where the person was engaging in foreign business as well as the person’s host country. As a result, the double taxation treaty allows foreign persons the ability to compete with local business because their products and services now have a more comparable advantage. However, the Double Taxation Treaty has created greater exchange of information duties.\(^6^1\) In particular, the Swiss Treaty requires the competent authority in Switzerland will

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provide information…in the form of authenticated copies of unedited original records or
documents” to U.S. authorities when there is an issue of tax fraud. Even though either country
does have the opportunity to terminate the treaty, the diplomatic process of terminating the
agreement takes six months to carry out. The UBS settlement agreement marks the first time
the Swiss have allowed for a fishing expedition. Before the settlement, the Swiss were willing to
cooperate with a treaty request if the U.S. authorities “clearly identif[ied] the taxable person
concerned.” Of course, with UBS’s employees engaging in conspiracy and the media hype as a
result, the Swiss are following through with this fishing expedition.

In addition, the MLAT has further taken away from the Swiss’s immunity from
international liability. In 1977, the MLAT treaty went into force. The treaty was undertaken “to
afford each other…mutual assistance in investigations or court proceedings in respect to offenses
the punishment of which falls … within the jurisdiction of the judicial authorities requesting state
[and compliance with such a request requires] effecting the production … of judicial or other
documents, records, or articles of evidence.” However, the MLAT treaty between the U.S. and
Switzerland does “not apply to investigations or proceedings concerning violations with respect
to taxes…” unless the person or persons are involved violent organized crime. Nevertheless,
certain offenses result in compulsory measures such as fraud against the requesting state and
subordination of perjury. A person is guilty of committing fraud against the United States when
they “knowingly execute, or attempt to execute, any scheme or artifice with the intent to defraud

63 Article 30, 3 U.S.T. 3972.
64 See Article 26, 3 U.S.T. 3972.
67 See Article(s) 2; 6(2) (a); 6(3), 27 U.S.T. 2019.
the United States.”\textsuperscript{69} A person is guilty of subordination of perjury in the United States when they “procure another to commit perjury.”\textsuperscript{70}

Even though the U.S. Authorities chose a request under the Swiss treaty, they could have been entitled to an MLAT treaty request because helping clients to file tax documents without disclosing offshore accounts is subordination to perjury.\textsuperscript{71} By allowing clients such as Olenicoff to certify false tax documents when UBS was the QI charged with ensuring the quality of the tax records, it committed a criminal offense. Also, since bank employees marketed bank secrecy to wealthy clients to evade taxes is a major fraud because it was a scheme to defraud the United States. Even if the MLAT treaty does not allow for treaty requests for tax violations, the treaty does clearly allow for a compulsory exchange of information for subordination of perjury and fraud against the requesting state. So, such a request would still bind the Swiss to the agreement.

In summary, by opening itself up to international cooperation through treaties, having people turn state’s evidence on the actions of its companies, and the U.S. law enforcement’s painstaking pursuit of wrongdoers, tax evaders will not have the ease as they did before to hide their money in Swiss accounts. Since the Swiss are now bound to the agreement because of the UBS Settlement, they cannot as easily rely on their bank secrecy laws.

\textbf{III. Why The U.S. May Not Gain the Same Leverage Over Tax Evaders in Other Tax Havens}

If nothing else, the UBS Settlement shows the extent of pressure needed to allow a fishing expedition of unidentified accountholders under a tax information treaty request. With that said, U.S. Authorities may be worse off diplomatically with other tax havens in comparison.

\textsuperscript{71} 26 U.S.C. §7206(1).
For example, the U.S. has only entered fourteen different TIEAs\textsuperscript{72} with tax havens in the last decade.\textsuperscript{73} Nonetheless, like the treaties set up between the U.S. and Switzerland, eighty-seven nations have pledged to adopt other OECD tax information sharing agreements.\textsuperscript{74} Moreover, other nations may have chosen to adopt similar agreements because of new multilateral support for economic incentives and sanctions.\textsuperscript{75} Of all the nations that were requested to comply with the OECD Model Convention, none are now considered “blacklisted.”\textsuperscript{76} All formerly blacklisted nations are now in compliance (including Switzerland) or plan to be sharing tax information in the future.\textsuperscript{77} Even though the OECD model convention has not infiltrated all tax secrecy jurisdictions, it is the best effort undertaken so far to thwart tax abuse. Accordingly, there are disadvantages and advantages to the accomplishments of the OECD Model Convention.

A. The Advantages of the Model Convention in Preventing Tax Evasion

The OECD is a multilateral cooperation effort to bring nations goals and objectives together. The convention is comprised of both model DTAs\textsuperscript{78} and model TIEAs depending on what is more suitable for the nations that are signing such agreements. DTAs, on the one hand, favor richer countries because the purpose of such an agreement is to help ease foreign direct investment (“FDI”) and richer countries are more likely to be engaged in FDI. TIEAs, on the other hand, are essentially informational sharing devices which better serve the poorer countries

\textsuperscript{72} “Tax Information Exchange Agreements”
\textsuperscript{73} Addison, Timothy V., Shooting Blanks: The War on Tax Havens, 16 Ind. J. Global Legal Stud. 703, 715-716, (2009) [hereinafter “Shooting Blanks”].
\textsuperscript{74} See Cong. Docs
\textsuperscript{75} G20Summit: An Update on the Move to Greater Transparency and International Cooperation in Tax Matters, http://www.oecd.org/document/38/0,3343,en_2649_201185_43777958_1_1_1_1,00.html (last visited on Oct. 21, 2009).
\textsuperscript{77} Id.
\textsuperscript{78} “Double Taxation Treaty”
that may have no or low taxes on income or profits. Accordingly, cooperation through model
convention agreements has led to remarkable tax compliance between nations.

Unlike any other multinational undertaking involving taxation, the OECD’s global forum
remains unmatched. The organization itself has over 200 committees and boasts some 40,000
senior officials. Because of the extensive participation by member countries, the model
convention serves as the principal source of guidance. For example, the model convention itself
undertook the task of creating model TIEAs for smaller tax secrecy jurisdictions and forced
cooperation with such arrangements through the threat of sanctions and blacklisting.

In addition, the OECD is receiving a larger foundation base as time goes by. Since April
2009, ninety TIEAs have been signed and sixty TIEAs have been negotiated or renegotiated to
reflect the new amendments. Also, all major onshore and offshore centers have embraced the
standards of tax information exchange proposed by the OECD or they are removing the
impediments surrounding the cooperation. Clearly, because of the worldwide support
surrounding the issue, tax evasion in offshore banking centers might be losing its lackluster.

B. The Disadvantages of the Model Convention in Preventing Tax Evasion

Some of the OECD Model Convention’s aspects stand in stark contrast of its purpose.

Given that many of these smaller island nations have come to depend on the revenue based on
offshore tax evaders, micro compliance by financial institutions will surely go to the wayside.
Although a great majority of tax secrecy jurisdictions are now in compliance or will be in the
future, there are still many obstacles the OECD needs to work through.

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80 TJN Briefing at .
81 Gurría, Angel. G20 Summit: An Update on the Move to Greater Transparency and International Cooperation in Tax Matters, (Pittsburgh Sept. 25, 2009),
http://www.oecd.org/document/38/0,3343,en_2649_37427_43777958_1_1_1_1,00.html (last visited on Oct. 19, 2009).
82 Id.
First, the framework of the model convention does not allow for ease in creating multinational agreements because there are roughly ninety member countries. For example, the new amendments to the convention must first pass the scrutiny of all member countries and if one or more countries do not agree with such a provision, the model convention itself will say something similar to “Austria does not agree with the article” or “Mexico reserves the right to….”83 This seeming lack of uniformity is a result of internal laws and administrative practices followed by each member state.84 Without changes to such laws, the model convention lacks the uniformity needed to allow for complete multilateral compliance.

Second, revealing information under a treaty request may cause problems because such information may not be readily available or it may have been collected in a manner intended to deliberately avoid detection.85 In particular, the only requirement under a TIEA request is that the requested party “uses all relevant information gathering measures to provide the applicant party what they requested.”86 Even if the country subscribes to KYC rules, “all relevant informational gathering measures” will serve little purpose if the identity is falsely recorded or intentionally altered. Even if information is collected correctly, exchanging that information may take time to process because bilateral treaties lack an automatic exchange.87 Instead, under the current exchange protocol, a requesting party must deliver a detailed case of the person involved and what information is being sought after.88 One example of an automatic information exchange program is The European Union’s Savings Directive,89 but the OECD does not have an automatic exchange even in the planning stages. Instead, a requesting party must make treaty

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84 See TJN Briefing.
85 Id.
86 Id.
87 Id.
88 Id.
requests but receiving such information under the current agreement standard “is sporadic, difficult and unwieldy for tax administrators under the best of circumstances.”90 Therefore, much more needs to be done to create further disclosure of tax information so informational requests become “continuous, easy and manageable.”

IV. The Three-Pronged Approach To Further Prevention of Offshore Tax Evasion

Notwithstanding the major advances made since the Gordon Report was published in 1981, more can be done to prevent tax evasion in the future. With all the advances made because of the UBS Settlement, further prevention will require a systematic, three-pronged approach aimed at three major reasons contributing to such abuse: (1) the tax-haven hiding behind its secrecy laws; (2) the financial intermediary marketing evasion; and (3) the wealthy individual who believes it is their God-given right not to pay taxes.

A. At the International Level

International diplomacy can be the strongest weapon against tax abuse. Although tax havens have gained their notoriety through liberal tax laws, incentives and sanctions can be used to loosen such laws. Currently, eighty-seven countries have joined the OECD Model Treaty.91 Although the model convention faces criticism for having fundamental flaws, it is the best international taxation compliance venture so far. By incentivizing and sanctioning countries into bilateral tax information exchanges, U.S. Authorities can further prevent tax evasion.

The OECD convention seems to be an answer to worldwide cooperation. By creating standards for nations to follow, cross-border tax evasion is slowly ending. However, the biggest problem, again, is the automatic exchange of information. Even so, an automatic exchange of information by itself may not be enough because KYC standards are flawed. In particular, the

91 See Cong Docs.
IRS initially considered granting QI statuses to countries which had tax information treaties or exchanges.\textsuperscript{92} But subsequently, the service decided to expand the QI program to include countries that they considered to have “acceptable KYC rules.”\textsuperscript{93} But there are inherent problems with appointing foreign banks as QIs. For example, the IRS’s current KYC standard for foreign accountholders in the Cayman Islands requires only photo identification such as a passport or driver’s license.\textsuperscript{94} By allowing foreign banks the ability to become a qualified intermediary, the agreement implies the entity will engage in the necessary tax withholdings of the U.S. taxpayers and grants an immunity of sorts of direct IRS auditing.\textsuperscript{95} Instead, an outsider is in charge of the auditing and the IRS is granted review of the outsider’s findings.\textsuperscript{96} Of course, if there is an inconsistency, the IRS can order more audits.\textsuperscript{97} But the main problem remains: the adequacy of the information obtained and the ease of access to that adequate information. So, if the convention increases KYC standards combined with an automatic exchange of information, taxpayers’ information would automatically be disclosed to the IRS. If KYC identification standards are increased so all member OECD countries are required to fingerprint every foreigner accountholder, then an automatic information exchange will prove more effective.

Like any other large, international organization, change can take time. The OECD’s primary purpose so far is collecting a membership base; but inevitably, they will need to provide tougher standards and quicker information exchange within the model treaty in the future.

**B. At the Transactional Level**

\textsuperscript{92} 1 Casey Fed. Tax Prac. §3:30:50
\textsuperscript{93} Id.
\textsuperscript{96} Rev. Proc. 2000-12, 2000-4 I.R.B., Sec. 10.01.
\textsuperscript{97} Rev. Proc. 2000-12, 2000-4 I.R.B., Sec. 10.06.
Since the IRS began the Offshore Credit Card Program ("OCCP"),\(^98\) John Doe Summons were sent to MasterCard, American Express, Visa and other financial and nonfinancial companies within the U.S.\(^99\) Despite these summonses producing U.S. taxpayer transaction information, it failed to produce most of the names of the accountholders.\(^100\) The IRS then embarked through the pain staking process of identifying "high risk, high income return" individuals who might match the transactions discovered through the summonses.\(^101\) Even though the OCCP has largely been a success with identifying transactions, little can be done to the undisclosed accountholders who do not use their accounts for debit card transactions. Unsurprisingly, these tax secrecy jurisdictions have laws that are unfavorable towards American interests. Since forcing such nations into compliance with American interests can be brought about by sanctions, scrutiny and preventing Americans from doing business with such nations, the U.S. should consider forbidding Americans from having offshore accounts in these jurisdictions until they come into compliance with U.S. interests.

One of the best preventive measures the U.S. authorities can do in forcing compliance is to "lock-out" financial institutions from doing business with American businesses. Congress should grant the broad authority to "the Treasury Department to bar U.S. financial institutions from doing business with the offending banks or jurisdictions and essentially locking them out of the U.S. financial system."\(^102\) One such organization within the Treasury that regulates foreign transactions is the Office of Foreign Asset Control ("OFAC").\(^103\) Besides serving foreign policy objectives, OFAC ensures compliance by assessing and imposing civil penalties and potential

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\(^{101}\) Id.

\(^{102}\) Cong Docs.

\(^{103}\) See the OFAC website, http://www.treas.gov/offices/enforcement/ofac/ (last visited on Oct. 10, 2009)
criminal charges for violators. For example, OFAC will impose a fine of 250 dollars if a person is in possession of a 250 dollar box of Cuban cigars. While the agency’s primary purpose is to target enemy transactions of the U.S., it can be granted broad authority to block wire transfers to and from tax secrecy jurisdictions, impose civil fines on institutions engaged in business with such nations, and impose criminal fines on those who place their money in the nation’s accounts. By tracking the source and implementing the strategy used in the UBS settlement, U.S. Authorities can bring lawsuits against the organizations who engage in such transactions. Therefore, this lock-out measure will prevent future transactions from taking place until substantial compliance with tax information standards is met.104

Since G-20 nations105 essentially control economic incentives and sanctions, compliance with information exchange will be inevitable. If tax information is being exchanged from tax secrecy jurisdictions, tax evaders will be less likely to hide their money in those countries. On the other side, if financial institutions are barred from transacting with offending jurisdictions, then tax evaders cannot send their money to hidden offshore locations. Of course, the “lock-out” provision will not block wealthy individuals from filling up their yachts with gold bars and setting sail for a tax secrecy jurisdiction. But again, this “lock-out” provision will add one more layer in ensuring tax compliance.106

C. At the Taxpayer Level

104 Id.
105 The G-20 nations are the economic powerhouse countries (and regions) of the world. This list includes: The U.S., The EU, United Kingdom, Brazil, China, Argentina, Russia, and Saudi Arabia. Please visit http://www.g20.org/about_what_is_g20.aspx (last visited Oct. 20, 2009).
The unfortunate part of having a great standard of living means having higher taxes. For example, in 2007 the top 1 percent of wealthy individuals in the U.S. paid 40.42 percent of all federal income taxes.¹⁰⁷ Until recently, these individuals were able to park their money in offshore accounts and use debit cards for their transactions.¹⁰⁸ But the long arm of the law has finally got closer to catching these individuals when the UBS settlement occurred. As a result, the IRS has allowed for the VDP, whereby individuals who elected to not disclose their offshore accounts can now make a disclosure without the risk of a criminal lawsuit.¹⁰⁹ Of course, these individuals are subject to civil penalties and the IRS may want an interview with the individual depending on the facts of the case. Certainly, the VDP has seen remarkable results.¹¹⁰

Whatever the reason for the VDP, the fear of U.S. Authorities has prompted some of these undisclosed accountholders to elect to voluntarily disclose. An increase of auditing “high wealth, high risk” individuals will only intensify this fear nonetheless. “While the IRS audited almost 9.25 percent of all individuals with incomes over 1 million in 2007, only 2.26 percent of those with incomes of between 200,000 and 1 million dollars were audited...leav[ing] a total of 3,942,702 individuals with an income of over 200,000 dollars [unaudited].”¹¹¹ So, increases in audits will likely be preventive towards tax evasion but some of these individuals will be sophisticated enough to hide their assets from auditors. Even so, adding an increase of audits

¹⁰⁸ See VMA.
¹¹⁰ Originally, only 7,000 people were thought to have disclosed their accounts. Wingfield, Brian, “IRS Sees Success In Anti-Evasion Campaign” (Forbes Nov. 17, 2009), http://www.forbes.com/2009/11/17/irs-amnesty-offshore-business-washington-tax.html (last visited on Nov. 17, 2009). However, IRS Commissioner Shulman announced that more than 14,700 U.S. taxpayers have participated in the VDP. Id.
with the trilogy of other preventive measures will help to curb the number of individuals engaged in tax evasion.

In addition, raising the maximum prison sentence for those who engage in tax evasion will not only deter more tax evasion, it will result in further voluntary disclosure. Accordingly, the maximum prison sentence for filing a false tax return is 3 years in prison and a 100,000 dollar fine or both.\textsuperscript{112} The maximum prison sentence is 5 years and a 250,000 dollar fine or both for tax evasion.\textsuperscript{113} Also, a willful and wanton nondisclosure of a foreign bank account carries a maximum of 10 years imprisonment and a fine of 500,000 dollars or both.\textsuperscript{114} Of course, a judge could order a taxpayer who is guilty of all the aforementioned crimes to serve the maximum sentence of 18 years—the 3, 5 and 10 year sentences combined concurrently—but the mandatory prison sentences are too low to serve as a sufficient deterrent.

Surely, Congress and the President have not felt the political pressures after the UBS Settlement as they did when the Bernie Madoff and Enron scandals came to light. If they had, public outcry would require stiffer penalties on those who engage in tax evasion. Indeed, the bankers and the wealthy Americans who are engaged in tax evasion are in a conspiracy to commit fraud. Therefore, Congress should enact a new statute that targets bankers and wealthy individuals conspiring to commit fraud against the American Government.

In particular, Congress should pass a new law that specifically targets financial institutions and wealthy clients who intentionally conspire or attempt to conspire with one another to evade taxes by using an offshore account. The effect of such a law would be devastating for financial institutions, if they choose to break the law. Not only would the banks face hefty criminal

\textsuperscript{112} 26 U.S.C. 7206(1).
\textsuperscript{113} 26 U.S.C. 7201.
\textsuperscript{114} 31 U.S.C. 5322(b).
sanctions, but they would also face derivative lawsuits on behalf of shareholders. Not even the business judgment rule\textsuperscript{115} could protect institutions from engaging in conspiracy.

By creating tougher penalties and standards, financial institutions and wealthy individuals will be less likely to engage in tax fraud. Financial institutions will create internal compliance initiatives to self-regulate and wealthy clients will be less likely to want to place their money offshore because presumably they are smart enough to know “if you can’t do the time, then don’t do the crime.” Again, creating new laws with stiff penalties and increasing audits undertaken will add to further prevention of tax evasion. And by increasing measures aimed at the taxpayer, the likelihood a person would engage in such a crime will diminish significantly.

V. Conclusion

Even though the problem of tax fraud will continue to happen in the future, progress can be made to prevent future funds from being hidden overseas. The UBS Settlement shows the persistence required before a tax secrecy jurisdiction will go on a fishing expedition. With greater information exchange standards, more transparency, and intimidation of institutions and wealthy individuals, U.S. authorities can sort out what tax liability is owed to the Government.

Until the U.S. Government moves to a national sales tax and does away with income taxes, people will continue to evade taxes. At this point in time, the benefits of having an undisclosed offshore account may continue to outweigh the risk. However, an argument for a nationwide sales tax is beyond the scope of this paper. What we have for now is a problematic system which can only be fixed through cooperation.

\textsuperscript{115} Navellier v. Sletten, 262 F.3d 923, 946 (9th Cir. 2001) (holding that the “business judgment rule” requires “[r]ationally believ[ing]…[the] business judgment is in the best interest of the [company].”).