By Barbara R. Hauser

Is 2009 the Year That Bank Secrecy Died?

The United States, OECD, G20 and several European countries all are working hard for transparency

The IRS' success against UBS AG seems to be the famed butterfly in the rainforest that causes gigantic ripples across the world.

The campaign against secret funds in Switzerland led the news. But several unrelated efforts in 2009 shared a common goal of finding money around the world and forcing the funds back to home countries. The result: in just one year, Switzerland, global banking, and perhaps the United States' relations with other countries' financial centers were forever changed.

U.S. v. Swiss

Switzerland began its current bank secrecy rules before World War II when many wealthy families in other European countries were nervous about the safety of their money. As political tensions increased, Switzerland became an attractive neutral country. That reputation for neutrality over the years also led to Switzerland's appeal if Europeans preferred not to pay their home country's income taxes. Switzerland accepted their funds without insisting on proof of payment of those taxes. As Swiss bankers and lawyers have explained it to me, Switzerland distinguishes between tax "evasion" (which is not considered to be a crime) and tax "fraud" (which is a crime). Therefore, if people from another country merely fails to declare income or assets to their home country's tax authorities, Switzerland does not feel obligated to share that information with the home country. Indeed, unless there's been actual fraud (such as declaring false amounts of income), national law general prohibits Swiss banks from disclosing information about the owners of Swiss bank accounts.

This lenient attitude toward home-country taxes, coupled with legendary bank secrecy and extraordinarily well-qualified investment houses has encouraged many Europeans (as well as South Americans and Americans) to move funds to Switzerland, funds that had not been taxed in their home countries. How much is a frequent topic for the Swiss. Informal estimates are that up to one-third of the private wealth held in Swiss accounts has been so-called "black money"—sometimes also referred to as "gray money" or more straightforwardly as "undeclared." Often, the owners of these funds were waiting for the home statute of limitations to run (frequently a 10-year period), after which they could bring the funds home.

Estimates also are that one-third of the entire world's private wealth is managed in Switzerland. That would mean the world's undeclared sums—and the loss of tax revenues to home countries—are enormous.

All of that changed in 2009 when the U.S. Internal Revenue Service (through the U.S. Department of Justice) successfully obtained the names of 4,450 U.S. taxpayers with bank accounts at the large Swiss bank UBS AG. Although 4,450 is just a fraction of the 52,000 names that the IRS initially requested, the fact that the U.S. agency was able to pierce the Swiss bank confidentiality is transformative.

IRS press releases boasted on its web site: "Abusive Tax Scheme Investigations—Fiscal Year 2009;" "Former UBS

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Banker Sentenced to 40 Months for Aiding Billionaire American Evade $7.2 Million Taxes." (The conviction occurred in Florida).

The immediate result was that many Swiss banks quickly adopted a strict policy of refusing to maintain accounts for U.S. resident taxpayers. Even I got a call from the Swiss banker who'd managed an account that I'd established while working in Zurich. "We are now closing your account," he said. "Where would you like the funds to be sent?"

The civil action against UBS AG culminated in an unprecedented "Agreement between the United States and the Swiss Confederation (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)," signed on Aug. 19, 2009.

Article 1 of that agreement requires the Swiss government to process the information request from the United States relating to open or closed accounts that satisfy criteria set out in the annex to the agreement. The parties estimate there are "approximately 4,450" such open or closed accounts of U.S. clients of UBS AG. The request and processing are carried out under the tax treaty between the United States and Switzerland, "for the prevention of 'tax fraud or the like.'"

Those investigations and prosecutions are proceeding apace. The *Financial Times* reported that on Nov. 6, 2009, Robert Moran, a U.S. yacht broker, was given a two-month sentence for tax fraud by a court in Fort Lauderdale, Fla. According to the *FT*, the sentence was relatively lenient because the UK-born Moran cooperated with the U.S. authorities; but it was significant because it was the first prison term resulting from investigations into U.S. clients with accounts at UBS AG.

Moran, 58, was the third former UBS client tried after the U.S. authorities this year gained the names of 255 of UBS' U.S. offshore customers as part of a $780 million (€525m, £470m) settlement of criminal charges against the bank, reported the *FT*.

Among the strong worldwide reactions, one of most extreme was emailed throughout Europe: It's a commentary, dated Aug. 24, 2009, from one of the oldest private banks in Switzerland, Wegelin & Co., founded in 1741. Entitled "Farewell America," the Wegelin bankers attack the United States' very morality as a nation: The United States is "[a] country that, over the last 60 years, has unquestionably been one of the most aggressive nations in the world. The USA has fought by far the largest number of wars, sometimes with, but mostly without a UN mandate. It has broken the international laws of war, maintained secret prisons, and fought an absurd war against drugs, with serious consequences both abroad (Columbia, Afghanistan) and at home."

Wegelin decries what it sees as the hypocrisy of the U.S. allegations that Switzerland is a tax haven: "With breathtaking moral duplicity, the USA maintains enormous offshore havens in Florida, Delaware and others of its states. The moralizers have joined sides with a nation that still makes extensive use of the death penalty, and that has a legal system under which lawyers can get rich on the misfortunes of their clients."

> The financial crisis encouraged many nations to seek additional revenue: International tax evasion was a tempting target.

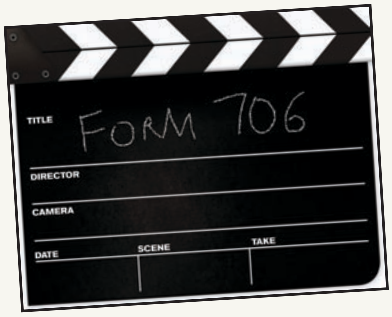
Wegelin goes on to blame the United States for the 2008-2009 global financial crisis: "The moralizers provide intellectual support for a country that allows its infrastructure to collapse. . . They fund a nation that tolerates—or rather, causes—regular crises in the global financial system that it manages. A country whose underclass enjoys neither the benefits of an adequate education, nor a halfway functional healthcare system; a country. . . in which saving and investing have increasingly become alien concepts, a situation that has undoubtedly been one of the driving forces behind the current recession, with all its catastrophic consequences for the whole world."

Finally, it bids America good riddance: "Potential aggression and economic progress are mutually exclu-

The Case of the Dead Movie Producer's Mistress

Bank secrecy also can work against beneficiaries. A remembrance

Barbara Hauser's article reminds me of a case in which I was involved probably 25 years ago while working as agent on Internal Revenue Service's international estates audits. The decedent was an American movie producer who lived and died at age 68 in Switzerland, but claimed to be domiciled in New York. The Form706 for his estate was filed with the district director in Manhattan; a friend of mine was assigned to audit the tax return.



I got involved in the case because of an informant. During the course of the examination, a rather spectacular looking young lady showed up at the IRS wearing an incredible black diamond mink coat. She was a 22 year-old model who had lived with the movie producer. The gross estate reported was about $2 million. The young lady, a citizen of one of the Scandinavian countries, had an interesting story to tell. She'd dropped out of college to live with the movie producer. He soon became sick with cancer but convinced her not to move out because he showed her documents verifying that he had the equivalent of $12 million in a Swiss bank account. He told her that when he died, the money would go to her.

About six weeks later when he died, she went to the bank to close the account and found that there was only $2 million left. She knew that the decedent's cousin had visited the bank about four weeks before while the movie producer was in a coma. Presumably, the cousin took the $10 million.

The auditor and I talked to the IRS criminal investigation division about this allegation but they would not take the case. We then went to the Justice Department and showed them the documentation. Justice thought we had an excellent case but the only documents we had were photostat copies of monthly statements. Justice wanted certified copies of statements.

The Swiss bank refused to give us the statements.

I then met two or three times at the Swiss Embassy with the charge d'affaires to discuss the matter. He was very polite but resolute. Under Swiss law, banking officials are constitutionally precluded from giving out any information about bank clients. The only exception to this rule is if officials from another country can prove that the owner of the account had committed a felony. In Switzerland, tax evasion is considered an administrative problem, not a crime so, the Mark Rich case notwithstanding, we were precluded from getting the certified documents from the bank. It was irrelevant to them that the taxpayer's cousin may have committed a felony under U.S. tax laws; the law in Switzerland was the one that governed their disposition of the matter.

In today's climate, the result might be the same in that the cousin still would have his loot, but he'd likely have to work harder for it. He may even have to sweat a little about the possibility of maybe doing some jail time—not because he'd robbed the 22-year-old mistress/model of millions but because he'd failed to pay the U.S. government taxes on his $10 million "gift."

One of the new criteria that the Swiss have announced for giving the IRS information about a particular account is the size of the account. Because this account in the contained more than US $1 million, it'd be one that the Swiss government would "give up" to the IRS.

Because the deceased move producer hadn't paid gift tax on the $10 million, transferee liability would place the liability on the cousin's head. Common sense would tell us that the cousin would be very aware of the fact that the IRS would be given his name, so he'd probably voluntarily disclose his $10 million "gift" in the hopes of reducing the penalties and potential criminal liability of his not having paid the taxes due.

In other words, nowadays the cousin still may be able to bilk the mistress—but probably not the U.S. government.

— Robert S. Blumenfeld, tax consultant, Weston, Fla.

sive. Which is why we are well advised to take a general farewell of America. This will be painful, for the USA was once the most vital market economy in the world. But for now, it's time to say goodbye."

This is not just a fit of pique thrown by a few Swiss bankers.[1] The rant found a wide audience in Western Europe among bankers, lawyers, investment counselors and wealth advisors of all stripes. We can only wonder what the ultimate backlash of the IRS' actions will be.

Other Nations' Efforts

But the IRS' attack on UBS was not the only move against global bank secrecy. The shocking financial crisis of late 2008 and most of 2009 encouraged many nations to seek additional revenue: International tax evasion was a tempting target.

Spurred by the success of the United States, France in August 2009 entered into a tax treaty with Switzerland. Shortly after that, Eric Woerth, the budget minister for France, announced: "We have obtained the names of 3,000 Swiss bank account holders, of which a part very probably corresponds to tax evasion." (French residents whom I was visiting at the time advised me not to believe these news reports.)

Italy meanwhile announced a third tax amnesty to try to bring money home (the first two were in 2001 and 2003). Predictions are that the Swiss banking town nearest Italy, Lugano, will suffer as Italians remove their funds. Prime Minister Silvio Berlusconi's own funds are being questioned. On Nov. 16, 2009, the *FT* reported that a television program would be claiming that he and his family have more than 60 million Euros in a private Swiss bank' Milan branch.

In a completely different twist on disclosure, newspapers in Norway now publish the taxable income of every resident. (It's a task undoubtedly made feasible by the fact that that the nation's entire population, including immgrants, is just under 5 million.)

Even the G20 Summit in Pittsburgh included an attack on the perceived tax havens that attracted funds that were thought to belong to one of the large countries. These countries pledged to shut down tax havens. French President Nicolas Sarkozy went so far as to claim that 60 percent of the world's hedge funds were based in tax havens.

The European Union Parliament endorsed the G20 goal of shutting down tax havens. In a resolution adopted by 308 votes in favor (just 30 against), the parliament called on the next G20 Summit to "agree on coordinated and concrete action both to close down all tax and regulatory havens and to close 'onshore' tax and regulatory loopholes which permit widespread tax avoidance even in major financial centres." The EU Parliament also included the following policy statement: "Parliament welcomes the G20 statement regarding bank secrecy and lauds automatic exchange of information as the most effective tool to tackle tax avoidance. MEPs recommend that the EU should adopt at its own level an appropriate legislative framework regarding tax havens and calls on its international partners to do the same."

Meanwhile, the Organization for Economic Development and Cooperation (OECD) is still working hard in its self-appointed role as watchdog over tax havens around the world that it claims prevent the larger countries from playing on a "level playing field." In 1996, the heads of the G7 nations asked the OECD to develop measures to "counter the distorting effects of harmful tax competition." Two years later, the OECD released "Harmful Tax Competition: An Emerging Global Issue." (All OECD member nations, except tax havens Luxembourg and Switzerland, approved the report). Over the years, the OECD has compiled an ever-changing black list of countries that do not comply with its level playing field rules.

The most recent black list had only four countries on it: Costa Rica, Malaysia, the Philippines and Uruguay. This year, all four promised to work on compliance, which moved them off the black list and on to a "gray list" (of countries that have agreed to comply but have not yet done so). So, for the first time, the black list is empty.

In September 2009, Switzerland signed a protocol to its tax treaty with the United States that incorporates the internationally agreed OECD tax information standard. The OECD reported that this is the 11th agreement for the exchange of information in tax matters signed by Switzerland that meets the OECD standard. (Of its 11 agreements, 10 are with OECD member countries, including major economic partners such as France, the United Kingdom and now the United States.)

Speculation has it that Singapore may profit from Switzerland's negative publicity, although it has worked to get on the "white list" at the same time. On Nov. 13, 2009, Singapore signed a protocol with France containing the OECD standard on transparency and exchange of information for tax purposes. The OECD reported that this is the 12th agreement that Singapore has signed in accordance with the OECD standard, so Singapore now moves off the gray list and into the category of jurisdictions deemed to have substantially implemented the standard.

U.S. Crackdown at Home

On the domestic front, the IRS also pushed to end taxpayers' banking secretly abroad, even as congressional efforts to end offshore tax havens languished.

The IRS gave new attention to the filings required of U.S. taxpayers who own or have authority over foreign bank accounts that contain more than $10,000 during a tax year. It's not against the law to have foreign bank accounts. There's also no penalty tax for having foreign bank accounts. But these accounts must be reported each year. An FBAR (Report of Foreign Bank and Financial Accounts) must be filed if:

(1) the person has a financial interest in, or signature authority (or other authority that is comparable to signature authority) over one or more accounts in a foreign country; and

(2) the aggregate value of all foreign financial accounts exceeds $10,000 at any time during the calendar year.

Why does the IRS require reporting? The reason given on its website is that: "foreign financial institutions may not be subject to the same reporting requirements as domestic financial institutions." Accordingly, the FBAR is "a tool to help the United States government identify persons who may be using foreign financial accounts to circumvent United States law."

The FBAR must be filed by June 30 each year, independently of the income tax return (that is to say, filed separately, and sent to Detroit). No extensions are allowed. Many (even most) U.S. taxpayers who are long-term residents in other countries are unaware of this requirement. But the penalties for failing to file are serious: Civil penalties can range from $10,000 (for negligence) to $100,000 or 50 percent of the amount in the account (whichever is larger). Criminal penalties can include up to 10 years' imprisonment.

The inclusion of accounts as to which a U.S. person has "signature authority" has caused some difficulties when, for example, a U.S. person is acting as an officer for a foreign company, with no right to any of the company accounts but with "signing authority." In August 2009, the IRS agreed to postpone the deadline for those situations and issued Notice 2009-62, extending the due date until June 30, 2010, for U.S. taxpayers who have "signature authority over, but no financial interest in, a foreign financial account and for U.S. persons with a financial interest in, or signature authority over, foreign commingled funds."

Even as the IRS widened the reporting net, it offered an amnesty program for those who filed a delinquent FBAR by Sept. 23, 2009 (which was then extended to Oct. 15, 2009). IRS Commissioner Douglas H. Schulman announced on Nov. 17, 2009, that 14,700 taxpayers had taken advantage of the program to disclose secret foreign bank accounts. "We are talking about billions of dollars coming into the U.S. Treasury," Shulman said.[2]

In October 2009, Shulman also announced that the IRS is creating a new unit, the "Global High Wealth Industry Group," to audit individuals with assets or income in the tens of millions of dollars. Audits are supposed to have begun by the new year.[3]

Congress hasn't been as productive in this arena—yet. Its "Stop Tax Haven Abuse" act, which gained early support from President Barack Obama, seems to have died, at least as Senate Bill 681. The current iterations, S. 506 and H.R. 1265 seem stuck in a committee, while the Obama administration is focused on health care. There are some reports, however, that new Stop Tax Haven Abuse bills may get tacked on to health care legislation, as a revenue producer for the added health care costs.

Whew!

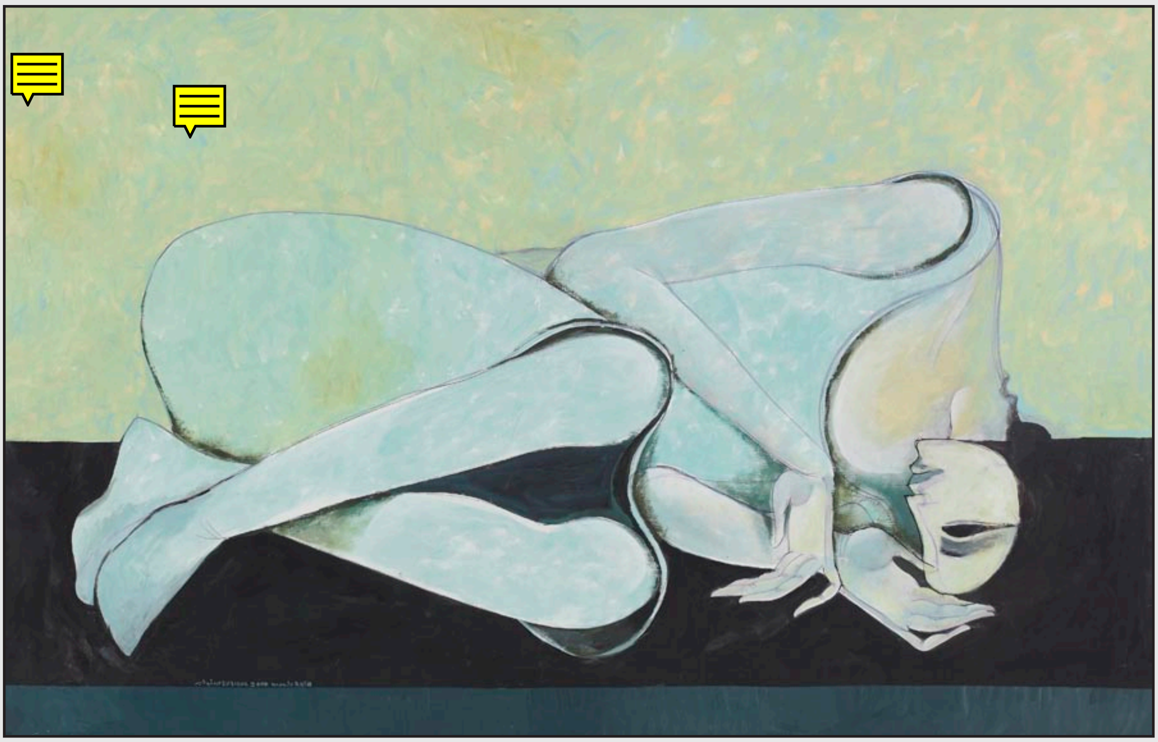
So, clearly, the big news for 2009 in the international practice of wealth management has been disclosure, transparency, information exchanges, and perhaps the end to bank secrecy around the world. The various jurisdictions are likely to continue their competition; wealthy families are likely to continue to forum shop.

Smaller in scale, but still interesting to wealth management professionals, are the trends of a decline in marriages (especially in France); the increased acceptance of same-gender marriages; gender categorization issues in general (India will now allow voters to check "male, female or other"); the growing number of controversial Shariah law courts in London (perhaps as many as 85); and the continuing debate in China on whether it can manage an inheritance tax.

Let's hope that 2010 proves as interesting—but much, much calmer. TE

Endnotes

1. For the record, one competing Swiss banker saw some "marketing" inconsistencies in the Wegelin statement (somewhat buried) that for those needing a U.S. exposure; "we expect that the range of non-US securities with American exposure [which Wegelin offers] will expand significantly."
2. Lynnley Browning, "14,700 Disclosed Offshore Accounts," *The New York Times*, Nov. 17, 2009, <*www.nytimes.com*>.
3. Martin Vaughan, "IRS Brings New Focus to Auditing the Rich," *The Wall Street Journal*, Oct. 28, 2009, <*www.wsj.com*>.



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