Growing Liability Risk to Foreign Financial Institutions from Tax Disclosure Cases

PETER ZEIDENBERG

Because, the author says, the era of bank secrecy is over, and the Department of Justice and the Internal Revenue Service are setting their sights overseas, a “do-nothing-and-hope-for-the-best” approach simply is not a viable strategy for foreign financial institutions.

Federal prosecutors in the United States have decades of experience building big criminal cases. They move methodically and rely on the induced cooperation of smaller targets, defendants whom the government believes have knowledge of others involved in the scheme. These smaller targets — the little fish — are grabbed first and their cooperation is leveraged by virtue of their unenviable position: they can fight the government’s allegations and face the prospect of a lengthy prison sentence or, alternatively, they can cooperate against larger targets — the big fish — and be granted far more lenient treatment. Human nature and prior experience have demonstrated that when faced with this choice, most defendants choose to cooperate with the government.

This is the stratagem government prosecutors have used against criminals of all stripes — from drug dealers to white-collar fraudsters such as Bernie Madoff. Given this history, it should not be surprising, then, that

Peter Zeidenberg is a litigation partner in the Washington, D.C., office of DLA Piper, whose primary focus is defending individuals and businesses in white collar criminal matters and related issues involving corporate governance and internal fraud investigations. He can be reached at peter.zeidenberg@dlapiper.com.
this same strategy is being employed to build criminal cases against for-
egn banks suspected of assisting US taxpayers in evading the payment of
US taxes.

The “little fish” in this scenario are US taxpayers who have hidden
their assets offshore in an effort to avoid lawfully due US taxes. The IRS’
recently concluded a stunningly successful Voluntary Disclosure program,
which resulted in nearly 15,000 US taxpayers coming forward to admit
that they had undeclared off-shore assets. In exchange for these admis-
sions, the US taxpayers were all but assured that they would not be pros-
ecuted criminally. Rather, their penalties would only be civil in nature,
and far less draconian than had the taxpayer not come forward voluntarily.

But the Voluntary Disclosure program did not come without strings
attached: all taxpayers seeking to take advantage of the Voluntary Disclo-
sure program had to agree to cooperate fully and honestly with the gov-
ernment. This means that the taxpayer had to agree to be debriefed by
law enforcement agents if requested, and to cooperate fully at any further
proceedings, i.e., at a grand jury or at a later trial.

The questions being asked of US taxpayers seeking entrance to the
Voluntary Disclosure program make clear what it is the government is re-
ally after. The government wants to know with whom at the foreign banks
the US taxpayer met with; when and how often they met; where these
meeting took place; and what the taxpayer was told by the foreign banker.

The answers to these and similar questions are irrelevant if the IRS
and the DOJ were interested solely in obtaining a full accounting of how
much in back taxes these taxpayers owed the government. They are, how-
ever, highly relevant if the government is intent on building a case on big-
ger targets, i.e., the foreign bankers with whom the taxpayers dealt and,
ultimately, the foreign banks themselves.

This strategy recently played out in a courtroom in Ft. Lauderdale,
Florida, where a 70 year-old former toy salesman, Jeffrey Chernick, was
sentenced for hiding $8 million in assets in a Swiss bank. In exchange for
Chernick’s full, honest and “substantial” cooperation against other, more
significant targets, the DOJ prosecutors recommended that Chernick receive
a sentence of six months house arrest. Had Chernick not cooperated with
the government, he was facing the likelihood of several years behind bars.
What did the government gain from making this deal? According to the prosecutor, a great deal. The government announced that due in large part to the cooperation of Chernick and several others who had taken advantage of the Voluntary Disclosure program, the government was able to accumulate sufficient evidence to indict former Neue Zuercher Bank manager Hanruedi Schumacher, and Swiss attorney Matthias Rickenbach. While both of these men are presently beyond the reach of the DOJ, the government informed the sentencing judge that it “continues to vigorously pursue and prosecute banks, bankers, and professionals in Switzerland and elsewhere who aided and assisted United States taxpayers in committing tax evasion by … hiding behind foreign financial privacy laws.”

The Chernick prosecutors also stated that the Schumacher and Rickenback indictments have led to investigations of their former banking clients — individuals who maintained accounts at a variety of financial institutions which DOJ was now targeting. The financial institutions now being targeted are not confined to Switzerland; they also reportedly include institutions in Hong Kong, Singapore, the Cayman islands, Liechtenstein, Luxembourg, Panama and Mexico.

NOT THE END, BUT THE BEGINNING

The Chernick prosecution is merely the beginning of what will undoubtedly be a long train of similar prosecutions. In the weeks and months ahead, the IRS and DOJ will be patiently combing through the information provided by the thousands of taxpayers who entered the Voluntary Disclosure program. Contained therein will undoubtedly be a treasure trove of information for prosecutors intent on building larger and more significant cases. DOJ will undoubtedly seek sealed indictments for those foreign bankers and wealth managers whose names turn up repeatedly in the disclosure statements. Should these individuals travel to the US they will be immediately arrested and, most likely, detained pending trial. Their unenviable but clear choice will then be the same as that of Mr. Chernick: fight the charges and face the prospect of years behind bars, or plead guilty and cooperate against others in the hopes for a lenient sentence.
And who is it that these foreign bankers can cooperate against? Rest assured that the DOJ is not interested in their cooperation against other US tax evaders. Rather, prosecutors will seek to turn these bankers and wealth managers into witnesses against their former employers. It is these foreign banks and financial institutions that are the true target of the DOJ’s focus.

DOJ’s strategy does face hurdles. Those foreign bankers and lawyers who assisted US taxpayers in evading taxes know what they have done and are sophisticated enough to know to avoid traveling to the US or other countries which have extradition treaties with the US. But even the most wary defendant can make mistakes — as Roman Polanski could undoubtedly attest.

But DOJ has the advantage of time on its side: sealed indictments will remain extant indefinitely. Once returned, even under seal, they effectively stop the running of the statute of limitations. Eventually, DOJ will catch these “bigger fish” and will then be in a position to leverage their cooperation against their former employers.

Some may wonder what is driving this strategy of DOJ’s; why are prosecutors so intent on going after these large, foreign financial institutions. The answer is the same that Willy Sutton gave when asked why he robbed banks: “that’s where money is.”

**WHAT MUST BANKS AND FINANCIAL INSTITUTIONS DO NOW?**

Foreign financial institutions must take the steps necessary to determine whether their employees’ past dealings with US taxpayers were handled appropriately or may have exposed the bank to criminal liability in the US. It is simply not sufficient to assume that bank procedures were complied with; due diligence must be performed to assure that this is the case. Institutions under the mistaken impression that if they have no branches or employees in the US then they cannot be subject to US criminal jurisdiction need to educate themselves. The DOJ will assert jurisdiction if it believes a foreign individual or institution conspired with a US taxpayer to evade the payment of US taxes — regardless of whether there was any physical contact with US soil.

Removing any remaining doubt as to what the future portends, the IRS
recently announced the hiring of 800 new revenue agents, and said that it would be opening offices in Beijing, Sydney and Panama City, as well as adding staff in eight other international cities, including Hong Kong. These are permanent, not temporary, hires and they demonstrate that the IRS and DOJ are putting the resources necessary into this all out effort to target foreign financial institutions.

The new reality is that the era of bank secrecy is over. DOJ and the IRS are setting their sights overseas. A “do-nothing-and-hope-for-the-best” approach simply is not a viable strategy for foreign financial institutions. While the tough tactics employed by the IRS and DOJ may strike many as inappropriately heavy-handed, these stratagems have a long track record attesting to their effectiveness. There is little reason to think that this tried-and-true approach will not be equally effective in the government’s pursuit of foreign banks and financial institutions.