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Beyond Switzerland: Managing Tax-Related Risks to Global Institutions Arising Out of US Person Accounts

For nearly a decade, the Tax Division of the US Department of Justice ("DOJ") and the Internal Revenue Service ("IRS") have been focused on investigating and prosecuting Swiss financial institutions for assisting US customers in evading US tax by maintaining unreported offshore accounts. The DOJ has acted against numerous individual institutions and private banks, demanding fines, penalties, interest, and restitution. The DOJ also has, through an agreement with the Swiss government covering the entire banking industry, accepted voluntary disclosures of US customer activity from scores of Swiss banks, resulting in additional hundreds of millions in fines. In addition, the IRS initiated a Voluntary Disclosure Program providing partial amnesty to individual taxpayers who came forward.

A significant consequence of these investigations and programs has been the disclosure of thousands of previously confidential customer names to the US government. Many of these US clients in the meantime are said to have fled to institutions in other offshore jurisdictions, including Southeast Asia, the Middle East, and Latin America, and the disclosure of transfer records in the Swiss investigations has identified many of those institutions. As a result, DOJ's investigations of offshore bank accounts maintained by US persons are focusing on an ever-widening circle of non-US banks. The DOJ's top tax prosecutor has publicly identified those institutions as the next investigative focus: "The money is moving out of Switzerland to a variety of jurisdictions," she said; "We're following leads and following the money, wherever that leads us."[1]

In the meantime, in the first months of 2016 the International Consortium of Investigative Journalists (the "ICIJ") publicly released a database containing information on more than 213,000 offshore entities created by the Panamanian law firm Mossack Fonseca. The database identifies many of the individuals associated with the shell companies, as well as the financial institutions and intermediaries involved in their formation. The US authorities have already indicated that they are investigating potential criminal liability that may apply to individuals, companies, and financial institutions that are named in the leaked documents – which will include scrutiny for offshore tax evasion.

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1 U.S. Chases Swiss Bank Secrets to Singapore and Israel, *available at* http://www.bloomberg.com/news/articles/2015-10-09/swiss-bank-secrets-lead-u-s-to-tax-cases-in-singapore-israel.

As one element of a risk assessment and management measure, institutions should assess their exposure to US clients, as well as their compliance with any reporting obligations under the Foreign Account Tax Compliance Act ("**FATCA**"), the US information reporting and backup withholding regime, and other international tax compliance regimes such as the Common Reporting Standard, and the EU Savings Directive.

Is My Institution at Risk?

Institutions most exposed to potential tax-related US enforcement action are those offering, or that have offered, private banking or wealth management/investment services to US persons. US persons are not just those physically in the United States, but also US citizens or dual citizens, Green Card holders, and domiciliaries, wherever located. Importantly, the rules also extend to offshore structures (trusts, companies, etc.) controlled by US persons.

In addition to potential risk exposure arising out of investigations into facilitation of non-compliance with US tax laws by US persons, non-US financial institutions maintaining accounts for US persons are now subject to specific US tax law compliance obligations under FATCA. FATCA focuses on reporting by foreign financial institutions about financial accounts held by US taxpayers or foreign entities in which US taxpayers hold a substantial ownership interest, and essentially serves as a backstop to the various self-reporting obligations of US taxpayers. Non-US financial institutions that make payments into the United States, or have other connections with the United States, also may have obligations under the US information reporting and backup withholding regime.

Tax-related investigations by the US authorities may result in the identification of other US law compliance issues arising under the ever increasing extraterritorial application of US banking, securities, and derivatives laws and regulations, which are generally triggered by the provision of cross-border services to US persons. Thus, the US pursuit of offshore tax evasion magnifies other US law compliance risks associated with the provision of financial services to US persons.

What should non-US financial institutions providing services to US persons be doing?

Non-US financial institutions providing financial services to US persons, even those who believe their US business to be minimal, should be proactive in their risk-mitigation measures in order to be able to determine whether, and the extent to which, they are exposed. These measures should take into account FATCA compliance obligations, but should also focus on other US legal or regulatory requirements that might be triggered by the provision of financial services to US persons.

Practical measures can include:

- **(i)** undertaking an assessment of the US tax and other regulatory risk exposure by assessing the scope and nature of the institution's historic and current US business;
- **(ii)** prompt action to ensure that the institution's current US business is managed in compliance with applicable US laws to minimize future exposure; and
- **(iii)** considering whether and how to undertake a more comprehensive internal review of the institution's historic and current US business in response to the preliminary assessment.

Being proactive in these respects has a number of important advantages. First, it can provide the financial institution with a realistic picture of its criminal and civil exposure (if any) for both historic and current conduct. Second, it will allow the financial institution to identify and implement any necessary corrective measures. And, third, it can ensure that the financial institution is best positioned in the event of any regulatory or criminal investigation, including in particular, with respect to possible substantial penalty reductions and minimizing exposure to individual employees, executives, and directors.

What should be your first move?

Undertaking this risk assessment can provide valuable insight for devising a prospective risk minimization strategy and can help determine whether a comprehensive review is advisable. Financial institutions should not undertake this exercise in a vacuum however. Experienced advisors who are actively engaged in representing non-US financial institutions in all facets of risk assessment, risk mitigation and enforcement defense can help to tailor a review and strategy suitable to the needs of the particular institution. Moreover, consulting with expert advisers can ensure that any risk mitigation strategy receives appropriate credibility by regulators and prosecutors, and does not present additional liability by failing to meet regulatory expectations. Our own philosophy is to empower each institution we represent to undertake proactive steps using its own internal control functions and resources in partnership with our specialist advisory teams.

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