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SPECIAL REPORT

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In this article, the authors discuss the increasingly serious consequences for foreign financial institutions that maintain undeclared accounts for noncompliant U.S. taxpayers, recommending steps that FFIs can take to minimize U.S. civil and criminal liability when engaging with U.S. customers.

Foreign financial institutions seeking to maintain or onboard U.S. account holders now do so at their increasing peril as a result of recent interrelated developments that enhance cross-border transparency and global exchange of information. These developments include: increased reporting requirements on U.S. taxpayers holding foreign bank accounts; U.S.-centric and bilateral reporting obligations imposed on FFIs; and the exchange of information under bilateral treaty obligations and tax information exchange agreements.

Of greatest significance, however, are the ongoing investigations by the U.S. Department of Justice of noncompliant U.S. taxpayers and the institutions and advisers assisting them across the globe. Armed with reams of data obtained from its successful investigation of Swiss banks and their noncompliant U.S. account holders, as well as the IRS offshore voluntary disclosure initiatives, the DOJ is pursuing noncompliant U.S. accounts wherever they exist. As stated by Acting Assistant Attorney General Caroline Ciraolo, ''Using the flood of information flowing from various sources, the department is investigating this criminal conduct, referring appropriate matters to the [IRS] for civil enforcement and pursuing leads in jurisdictions well beyond Switzerland.''[1]

FFIs must become familiar with several areas of U.S. tax and criminal law to avoid potential exposure to civil and criminal penalties under U.S. law. This article addresses: (i) the underlying issues that gave rise to this new reality; (ii) the multifaceted U.S. provisions to obtain and confirm information on offshore accounts held by U.S. persons; (iii) why an FFI must now be especially sensitive to U.S. law, even if it has no U.S. presence; (iv) U.S. government offshore account initiatives; and (v) proactive approaches that FFIs should adopt to identify, mitigate, and/or remediate risk arising from undisclosed U.S. accounts.

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[1] *See also* Department of Justice, Office of Public Affairs, Release, ''Justice Department Announces Final Swiss Bank Program Category 2 Resolution With HSZH Verwaltungs AG'' (Jan. 27, 2016).

The Problem

The U.S. taxes its citizens, residents, and lawful permanent residents (''green card'' holders) on their worldwide income, requiring them to report, file, and pay tax on their income wherever derived. For several decades, there has been widespread noncompliance among U.S. taxpayers through the use of undeclared foreign accounts.[2] While noncompliance with U.S. tax reporting, filing, and payment obligations is often intentional, it can also happen inadvertently.

Unintentional cases of noncompliance generally involve U.S. dual nationals living abroad; foreign nationals with lawful permanent resident status who left the U.S. unaware that they would continue to be treated as U.S. taxpayers unless the status was properly terminated; or ''accidental'' U.S. citizens (for example, those who were born in the U.S. but left shortly after birth and never returned, remaining unaware of their U.S. citizenship status).

Undeclared foreign financial accounts are estimated to cost the U.S. Treasury at least $100 billion annually.[3]

U.S. Efforts to Obtain Information

The U.S. has reinforced the worldwide income tax reporting obligation over the years with increasingly complex reporting obligations designed to identify U.S. taxpayers' foreign assets and income. The first of these obligations is the disclosure, made under penalties of perjury, on the individual income tax return of whether the taxpayer had an interest in or signature authority over a financial account in a foreign country.

Taxpayers with foreign assets or income must separately file an annual Foreign Bank and Financial Account Report (FBAR) on accounts that in the aggregate contained more than $10,000 at any time during the previous calendar year.[4] Taxpayers now also face numerous other international information return obligations to reveal ownership of foreign financial assets or entities as well as associated income.

Since the implementation of the Foreign Account Tax Compliance Act and complementary bilateral intergovernmental agreements in 2014, the U.S. has begun to obtain third-party confirmation of U.S.-owned foreign financial accounts[5] and related income. These confirmations received under FATCA are more extensive to those furnished to the IRS by U.S. financial institutions in relation to domestic financial accounts.

FFIs: Ensuring Tax Compliance

Are FFIs required to ensure that their U.S. account holders comply with U.S. tax laws? Historically, FFIs might have argued (depending on their country of residence) that they were not, believing that:

- they were required to follow only local law;
- local law does not treat tax evasion as a crime;
- helping an offshore account holder evade or avoid home-country taxation was common in the local banking industry and not contrary to local law;
- U.S. law was irrelevant, particularly if the local financial institution had no U.S. presence;
- local bank secrecy provisions precluded disclosure of client information and shielded the financial institution from U.S. prosecution; and/or
- local law contained no provision requiring local financial institutions to ascertain home country tax compliance or to close accounts held by offshore customers, irrespective of whether the financial institution initially knew or later learned of the account holder's home country noncompliance.

In 2009, however, the deferred prosecution agreement (DPA) with UBS AG, Switzerland's largest bank, imposed U.S. criminal law sanctions and penalties on the Swiss banking system for the first time in history, significantly changing the position of FFIs in this context.

U.S. criminal conduct requires *mens rea*, or criminal intent. Generally, a crime cannot be committed under U.S. law without an intentional act that the actor knew to be against the law. Under the conscious avoidance (or ''willful blindness'') concept, however, the *mens rea* requirement can be satisfied without *actual* knowledge that the underlying conduct was criminal — that is,

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[2] An undeclared foreign financial account is an account maintained in a foreign country and held (directly or indirectly) by a U.S. citizen or resident alien that has not been properly and timely reported by the individual account holder to the IRS on an income tax return and the required Report of Foreign Bank and Financial Account form and/or on other international reporting forms. The FBAR form in prior years was printed on Form TD F 90-22.1. On September 30, 2013, the Department of Treasury Financial Crimes Enforcement Network posted a notice on its website announcing that the current FBAR form, FinCEN report 114, would replace the TD F 90-22.1.

[3] *See* http://www.justice.gov/tax/offshore-compliance-initiative.

[4] *See supra* note 2.

[5] A U.S. account, under FATCA (and IGAs), means a financial account maintained by an FFI that is held by one or more specified U.S. persons or U.S.-owned foreign entities. Treas. reg. section 1.1471-5(a)(2). A financial account generally means (i) a depository account, (ii) a custodial account, (iii) equity or debt interests in a nonpublicly traded investment entity, (iv) a cash value insurance contract, and (v) certain nonpublicly traded equity or debt interests in a holding company, treasury center, or other financial institutions. Treas. reg. section 1.1475-5(b). A specified U.S. person generally means an individual who is a U.S. citizen or resident and nonpublicly traded U.S. corporations, U.S. trusts, partnerships, and estates. Treas. reg. section 1.1473-1(c). A U.S.-owned foreign entity means any foreign entity that has one or more substantial U.S. owners. Treas. reg. section 1.1471-5T(c).

when the actor turned a blind eye to his conduct and failed to make appropriate inquiry.

FFIs may be criminally liable under U.S. law with respect to the opening, maintenance, or closing of undeclared U.S. foreign financial accounts if the FFIs: (i) knowingly conspired with or (ii) aided and abetted the account holder to open or maintain the account or (iii) opened or maintained an account while turning a blind eye to clear indications that an account was undeclared in the U.S.[6] FFIs may be subject to U.S. criminal law even if none of their employees traveled to, or worked in, the U.S. in connection with the undeclared account and despite the institution having no U.S. presence.[7]

In reviewing account activity for criminal conduct, U.S. prosecutors seek to identify so-called badges of fraud. For example, criminal culpability could arise if a banker suggested to a U.S. taxpayer that he could avoid detection by using numbered or coded accounts, hold mail agreements, and/or creating offshore structures (such as ''nominee'' foreign corporations, trusts, foundations, and so on). The implementation of any of these mechanisms, especially in combination, has given rise to the DOJ's position that, in absence of evidence to the contrary, the banker and/or institution involved either had actual knowledge that the U.S. taxpayer client was noncompliant, or turned a blind eye toward such noncompliance.

Other common conduct — such as repeated cash-based transactions of amounts just under $10,000, subversion of an IRS qualified intermediary agreement, closure of a U.S. account with loans or gifts to nominee third parties, or similar conduct — may also create the same criminal exposure for the individuals and institutions involved. The DOJ has gone so far as to consider in some cases a ''no questions asked'' onboarding by a foreign bank of a U.S. taxpayer account transferred from a Swiss bank after the 2009 UBS DPA, standing alone, as evidence of the onboarding bank's possible criminal intent.

U.S. Offshore Compliance Initiatives

In the aftermath of the UBS DPA, the U.S. has implemented two complementary offshore account initiatives:

- The DOJ offshore compliance initiatives, which target FFIs and facilitators involved in the use of foreign financial accounts to evade U.S. tax obligations.
- The IRS offshore voluntary disclosure initiatives, which focus on noncompliant U.S. taxpayers.

These initiatives are intended to combat, in tandem, the use of undeclared foreign financial accounts to evade or avoid U.S. tax laws and to encourage compliance by U.S. taxpayers. The first set of initiatives targets FFIs and individuals that facilitate tax evasion. The second set targets noncompliant U.S. taxpayers and offers them an opportunity to remediate their past wrongdoings and come into compliance. Not only do these enforcement efforts give noncompliant taxpayers a chance to remedy past wrongdoings, they also raise revenue from taxes and penalties collected from participants.[8]

DOJ Offshore Compliance Initiative

The DOJ initiative contains two components: the general compliance initiative and the program specifically designed to target Swiss banks.

General Initiative

The general compliance initiative began in 2008 with the investigation of UBS. On February 18, 2009, the investigation culminated in the institution entering into a DPA[9] with the DOJ after admitting guilt on charges of conspiring to defraud the U.S. by impeding the IRS. UBS agreed to stop providing banking services to U.S. customers with undeclared accounts and to pay $780 million in fines, penalties, interest, and restitution.

The IRS received account information, previously protected by Swiss bank secrecy laws, on around 250 to 300 U.S. taxpayers who held undeclared accounts at UBS. Around six months later, UBS, the Swiss government, and the DOJ entered into another agreement requiring UBS to provide account information on approximately 4,450 U.S. accounts to the Swiss Federal Tax Administration and ultimately to the IRS.

Since the UBS investigation became public, the DOJ has investigated and prosecuted FFIs and facilitators that may have helped U.S. taxpayers evade tax and reporting obligations using undeclared accounts.

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[6]For amplification on these principles, see Sharp, Granwell, and Katzberg, ''The US DOJ Voluntary Disclosure Program for Swiss Banks: What the Umbrella Man Can Teach Bank Counsel About Criminal Intent,'' *International Tax Review*, Feb. 13, 2014.

[7]In January 2013 Switzerland's oldest private bank, Wegelin & Co., became the first foreign bank to plead guilty to felony charges. The bank admitted to conspiring to defraud the U.S. by helping U.S. account holders secrete assets in undeclared foreign financial accounts. Wegelin pleaded guilty rather than contesting the court's jurisdiction over the bank, which had no offices in the U.S.

[8]The U.S. has reportedly collected over $13 billion from individuals and financial institutions in connection with secret offshore accounts since 2009, when the U.S. began targeting undisclosed foreign accounts after the UBS prosecution. *See* Laura Saunders, ''U.S. Expects to Collect $1.36 Billion From Swiss Banks That Helped Clients Hide Money,'' *The Wall Street Journal*, Jan. 27, 2016.

[9]In a DPA, the government charges the entity via criminal information, which it agrees to dismiss at the end of a specified term if the entity has fully complied with the terms of the agreement.

By way of illustration:

In January 2013, Wegelin pleaded guilty to felony charges and agreed to pay $74 million to the U.S. government. Wegelin sold its non-U.S. business to another Swiss bank and closed its doors.

In the same month, Liechtensteinische Landesbank AG agreed to pay more than $23.8 million to the U.S. government and entered into an non-prosecution agreement (NPA).[10] The DOJ also identified a number of Swiss banks that were under ongoing criminal investigation as of August 29, 2013, the date the DOJ's Swiss bank program was announced. These so-called category 1 banks were ineligible for the program.

In November 2013 the U.S. District Court for the Southern District of New York approved the U.S. government's ex parte petition to serve a John Doe summons on several U.S.-based banking institutions with respect to any financial accounts maintained at, monitored by, or managed through the Bermuda-based Butterfield Group (with offices in the Bahamas, the Cayman Islands, Guernsey, Switzerland, and the United Kingdom). The U.S. government's attack on bank secrecy was thereby extended to the Caribbean and beyond.

In May 2014 Credit Suisse Group, a category 1 bank that had been undergoing a DOJ investigation, pleaded guilty to conspiring with U.S. taxpayers filing false U.S. income tax returns and other documents with the IRS. Credit Suisse paid $2.6 billion in fines: $1.8 billion to the DOJ, $100 million to the U.S. Federal Reserve, and $715 million to the New York State Department of Financial Services.[11] Although the licenses of banks guilty of federal crimes can be revoked, Credit Suisse was allowed to remain in the licensed banking business.

In December 2014 the Bank Leumi Group became the first Israeli-based bank to reach a settlement with U.S. authorities in this context. It entered into a DPA with the DOJ, provided the IRS with the names and information of over 1,500 U.S. account holders, and paid fines of $270 million to the DOJ[12] and $130 million to the New York Department of Financial Services.

In 2015 the DOJ continued to actively investigate category 1 banks. With respect to category 2 banks, the DOJ reviewed their submissions, requested additional information as necessary, made penalty determinations, and negotiated and executed NPAs. The DOJ also investigated other banks and bankers that were not part of the Swiss bank program. For example, in September 2015 the U.S. District Court for the Southern District of Florida authorized the issuance of John Doe summonses to seek records of Belize Bank International Ltd.'s and Belize Bank Ltd.'s correspondent accounts at Citibank and Bank of America. The records would identify any U.S. taxpayers who held accounts at Belize Bank International Ltd., Belize Bank Ltd., or their affiliates, including other foreign banks that used those correspondent accounts at Citibank or Bank of America to serve U.S. clients. The court also granted the IRS permission to seek records related to Citibank's and Bank of America's correspondent accounts for Belize Corporate Services and information related to its deposit accounts at Bank of America. Belize Corporate Services offers the purchase of ''shelf'' Belizean international business companies.

Thus far in 2016, apart from concluding category 2 of the Swiss bank program, the DOJ announced the filing of criminal charges against Julius Baer & Co. Ltd., a financial institution headquartered in Zurich, Switzerland. Julius Baer was charged with conspiracy (i) to defraud the IRS, (ii) to file false federal income tax returns, and (iii) to evade federal income taxes. Julius Baer entered into a DPA under which it admitted to knowingly assisting many U.S.-taxpayer clients in evading their U.S. tax obligations. The DPA requires Julius Baer to pay a total of $547 million. In addition, two Julius Baer advisers pled guilty to felony tax evasion charges. (Prior coverage: *Tax Notes Int'l*, Feb. 15, 2016, p. 576.)

The DOJ announced on January 29 that it will continue to pursue pending category 1 bank investigations and is looking beyond Switzerland at numerous other jurisdictions, such as Belize, the British Virgin Islands, the Cayman Islands, the Cook Islands, India, Israel, Liechtenstein, Luxembourg, the Marshall Islands, and Panama, to name a few.[13] Practitioners report trends of enforcement in other parts of the globe: Asia, including China, Hong Kong, and Singapore; the Caribbean and Central America; and the Middle East, including

[10]An NPA is the U.S. government's written promise not to prosecute a person or entity if the person or entity meets all conditions set forth in the agreement. In the Swiss bank context, conditions include full and complete cooperation in providing all banking information requested to identify and prosecute noncompliant U.S. taxpayers and/or Swiss bankers. The agreement will generally not be made public unless the prosecution seeks to publicize the result of its investigation or the entity is otherwise required to disclose the agreement.

[11]Earlier in 2014, Credit Suisse paid approximately $196 million in disgorgement, interest, and penalties to the Securities and Exchange Commission for violating the federal securities laws by providing cross-border brokerage and investment advisory services to U.S. clients without first registering with the SEC.

[12]Of this amount, $157 million related to Leumi Private Bank in Switzerland, a category 1 bank.

[13]According to Acting Assistant Attorney General Caroline D. Ciraolo's remarks at the American Bar Association's Tax Section Midyear Meeting on January 29, 2016, reprinted by Tax Analysts. Ciraolo also announced that since 2008 the DOJ has publicly charged more than 100 account holders and nearly 50

(Footnote continued on next page.)

Dubai. These efforts were widely predicted since many noncompliant U.S. taxpayers had been transferring assets from Swiss banks to financial institutions in other countries. The DOJ's intention to ''follow the money'' in this regard is hardly surprising.

The Swiss Bank Program

On August 29, 2013, the DOJ and the Swiss Federal Department of Finance announced the Program for Non-Prosecution Agreements or Non-Target Letters for Swiss Banks. The program allows Swiss banks not already under DOJ investigation to resolve their criminal exposure in the United States.

The Swiss bank program is the first DOJ voluntary disclosure program targeted at a specific industry in a specific country, and it provides substantial benefits for both parties. It enables the Swiss government and its banks to definitively resolve potential U.S. criminal exposure related to undeclared U.S. financial accounts and to do so within Switzerland's legal framework. From the perspective of U.S. law enforcement, the program enabled the DOJ (1) to obtain key information on the conduct of Swiss banks and their undeclared U.S. account holders that otherwise would have been unobtainable under Swiss secrecy laws and (2) to impose appropriate financial penalties.[14]

The Swiss bank program targets category 2 Swiss banks — that is, a Swiss bank that has reason to believe it may have committed tax-related or monetary transaction offenses.[15] If an eligible Swiss bank voluntarily came forward under the program, it could avoid a potential DOJ criminal investigation and prosecution for events that took place between August 1, 2008, and December 31, 2014, provided that the bank meets and complies with specific terms and conditions.

The terms and conditions of the program require that Swiss banks:

- make complete disclosures of their cross-border activities;
- provide detailed information for every account in which U.S. taxpayers have a direct or indirect interest;
- cooperate in treaty requests for account information;
- identify the financial institutions that transferred funds into or received funds out of the accounts (known as ''leavers'');
- close accounts of customers who failed to comply with U.S. tax reporting obligations; and
- pay an appropriate penalty.

Swiss category 2 banks that meet all of the above requirements are eligible for NPAs. On January 27 the DOJ announced that it had concluded its final NPA under the program, having executed 78 NPAs with 80 Swiss banks since it announced the first NPA under the program on March 30, 2015.[16] Almost $1.37 billion has been imposed in penalties.[17] The category 2 Swiss banks that entered into NPAs disclosed over 35,000 U.S.-related accounts holding almost $50 billion in assets under management in those accounts from 2008 to 2013.[18] It is estimated that the penalties amounted to 2.7 percent of the assets under management.

As impressive as these figures are, they represent only one aspect of the Swiss bank program's success. Participating banks were required to close accounts of recalcitrant account holders and provide the U.S. with a treasure trove of otherwise unobtainable information on noncompliant taxpayers and those who assisted them. In closing accounts of recalcitrant account holders whose funds were not repatriated to the U.S., prosecutors can identify which banks in which countries now hold these funds that are still purportedly undeclared. Coupled with the information obtained through the IRS voluntary disclosure initiatives, this enormous

individuals who have aided and assisted U.S. taxpayers in concealing foreign accounts and evading U.S. tax obligations. Criminal resolutions were reached with six FFIs. (These remarks were made before the outcome in the Julius Baer case was announced on February 4.)

[14]For a detailed description of the program, including a summary of the other categories (3 and 4), see Sharp, Granwell, and Katzberg, ''The U.S. DOJ's Swiss Bank Voluntary Disclosure Program: An Update,'' *Tax Notes Int'l*, Mar. 10, 2014, p. 937. For post-March information on the Swiss bank program, see Nathan J. Richman and Tom Kasprzak, ''Final Swiss Bank Program Non-Prosecution Agreement Reached,'' *Tax Notes Int'l*, Feb. 1, 2016, p. 427.

[15]Given the focus of this article, we do not discuss category 3 or category 4 banks under the Swiss bank program or the so-called category 5 banks that opted not to participate.

[16]The DOJ also announced that a Swiss asset management firm had executed an NPA under the Swiss bank program, even though it was not eligible for the program. The DOJ stated the agreement reflects the department's ''willingness to reach fair and appropriate resolutions with entities that come forward in a timely manner, disclose all relevant information regarding their illegal activities and cooperate fully and completely, including naming the individuals engaged in criminal conduct.'' See DOJ, Office of Public Affairs, ''Swiss Asset Management Firm Finacor SA Reaches Resolution with Justice Department,'' Oct. 6, 2015, *available at* http://www.justice.gov/opa/pr/swiss-asset-management-firm-finacor-sa-reaches-resolution-justice-department.

[17]The highest penalty under the Swiss bank program was $211 million. The next highest amounted to almost $188 million, and several came close to $100 million. Penalties were based on the date the U.S. related accounts were opened and the maximum aggregate dollar value of all such accounts during the applicable period, as these terms are defined in the Swiss bank program. Banks could reduce the amount subject to penalty if they were able to show that accounts were either already declared to the IRS or disclosed under the IRS's OVDP before the NPA was signed. *See* Richman and Kasprzak, *supra* note 14.

[18]*See* Richman and Kasprzak, *supra* note 14.

database is a powerful arsenal against noncompliant account holders and foreign banks well beyond Switzerland.

Offshore Voluntary Disclosure Initiatives

The IRS voluntary disclosure initiatives are generally available to U.S. taxpayers who are not under IRS examination or subject to a criminal investigation and who meet the conditions for the specific program.[19] The offshore voluntary disclosure initiatives are available indefinitely, and the IRS can withdraw the program at any time. IRS Commissioner John Koskinen recently hinted that the program would end ''at some point.''[20]

There are three categories of IRS offshore voluntary disclosure initiatives:

- *Streamlined Foreign/Domestic Offshore Procedure*s. These are available to taxpayers who certify that their failure to report foreign financial assets and pay all related taxes did not result from *willful conduct*[21] on their part. The procedures allow eligible taxpayers to file amended or delinquent returns, providing terms for satisfying tax and penalty obligations. The procedures are available to U.S. individual taxpayers residing outside the United States and U.S. individual taxpayers residing in the United States (subject to a 5 percent penalty). Over 30,000 taxpayers have used streamlined procedures to come into compliance with U.S. tax laws.[22]
- *Offshore Voluntary Disclosure Program.* This program is available to taxpayers who are concerned that their failure to report income, pay tax, and submit required information returns *was due to willful conduct* and who seek assurance that they will not be subject to criminal liability and/or substantial monetary penalties as a result. The program imposes a 27.5 percent offshore penalty on the highest aggregate value of U.S. noncompliant foreign assets during the period covered by the disclosure. The penalty increases to 50 percent in some cases, including those in which the FFI involved has been publicly identified as being under IRS or DOJ investigation or if it is cooperating with the government in connection with U.S. taxpayer-owned accounts. More than 54,000 disclosures have been submitted under this program, and the IRS has collected over $8 billion as a result.
- *Delinquent FBAR and International Information Return Submission Procedures.* If a taxpayer is late in filing an FBAR but has filed and paid on time the U.S. tax due on accounts that should be reported on an FBAR, the IRS will generally not impose a penalty, provided the taxpayer files a statement explaining the late filing. A similar forgiveness procedure applies to delinquent filing of international information returns, provided the taxpayer provides a statement reflecting reasonable cause for not filing on time.

FFIs: Actions to Mitigate Risk

Given these developments, FFIs and their account holders can no longer assume that their activities are protected by bank secrecy provisions. Instead, they should assess their vulnerabilities and prepare for any repercussions that might lie ahead.

Proactive Steps

So what should an FFI do if it has historically maintained, continues to maintain, or decides to onboard U.S. account holders?

1. The FFI should scrupulously adhere to local anti-money-laundering, know-your-customer laws and other applicable local law provisions.

2. For existing client accounts, the FFI should reconfirm whether it has U.S. reportable accounts,[23] based on the guidance contained under FATCA or an IGA, as applicable. The FFI must ensure that it has all of the information necessary to meet its obligations under its FFI agreement or an IGA.

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[19]For a summary of the latest IRS voluntary disclosure initiatives, see Sharp et al., ''Recent Modifications to U.S. Offshore Voluntary Disclosure Programs,'' *Tax Notes Int'l*, July 7, 2014, p. 39. For an article on earlier IRS disclosure initiatives and related DOJ action, foreshadowing the August 2013 release of the Swiss bank program, see Sharp, ''Navigating Offshore Tax Hazards: An Update,'' *Tax Notes Int'l*, May 13, 2013, p. 695.

[20]''At some point, we will have assumed that people have had enough notice that they should have become voluntarily compliant''; ''At that point — after some period of time and you're not compliant — it will be assumed that logically you are purposely not compliant.'' Koskinen, Remarks at George Washington University Law Conference on International Taxation, Dec. 17, 2015.

[21]''Non-willful'' conduct is that which is due to negligence, inadvertence, or mistake or conduct that is the result of a good-faith misunderstanding of the requirements of the law.

[22]Another consequence of the swathes of data now in the DOJ's possession as a result of the Swiss bank program is that DOJ lawyers have been using account information provided by the Swiss banks to test whether a U.S. streamlined candidate truly acted without criminal intent. For example, if the bank records reveal badges of fraud conduct omitted from the streamlined filer's submission, this might lead to the rejection of the filing (or worse).

[23]The term ''U.S. Reportable Account'' means a financial account (that is, an account maintained at a reporting FFI) and held by one or more Specified U.S. Person or by a Non-U.S. Entity with one or more Substantial U.S. Owners (under ''classic'' FATCA or Controlling Persons (under an applicable IGA) that is a Specified U.S. Person. Capitalized terms have the definition under FATCA or an applicable IGA.

3. For new clients, or funds received from existing clients, obtain certification (under local penalties of perjury provisions) that the new U.S. client is U.S. tax compliant (and, if necessary, perform further due diligence to confirm that certification). The FFI should not open any new U.S. accounts except on condition that the account will be declared in the U.S. and will be subject to disclosure by the FFI (under FATCA/IGAs or otherwise).

This is particularly important with respect to funds that may be received from ''leavers,'' that is, account holders who moved their funds from institutions already facing investigation, because, depending on the circumstance, that type of activity, standing alone, may well be viewed by the DOJ as conduct evidencing the badges of fraud.

4. If an FFI ascertains that the U.S. account holder of an existing account is not U.S. tax compliant, inform the U.S. account holder in writing of the IRS Voluntary Compliance Initiatives. Inform the U.S account holder to remediate his noncompliance, or face account closure. If the account holder does not remediate his U.S. nontax compliance, the FFI should exit the account holder.

5. The FFI should close (as soon as practicable) all accounts of ''recalcitrant'' account holders; that is, accounts with respect to which the account holder does not provide the due diligence, reporting information required by FATCA/IGAs. Closing mechanisms must assure transparency. This can be done by the FFI implementing procedures to prevent bank employees from assisting recalcitrant account holders from engaging in acts of further concealment in connection with the closing of any account or the transfer of any funds.

6. Overall, and related to the foregoing actions, an FFI under ''classic'' FATCA or a Model 2 IGA must establish a written compliance program under the authority of a so-called ''responsible officer'' to comply with its due diligence, reporting, withholding, and other obligations under its FFI Agreement, as well as its obligations under the Model 2 IGA. The FFI must also perform, or have performed on its behalf, a review of its compliance program. So too, an FFI under a Model 1 IGA should establish a comparable compliance program. An effective compliance program is essential for an FFI to be in a position to make any required certifications and to have procedures in place to remediate any deficiencies in its overall program.

As part of its overall compliance program, the FFI should implement policies that clearly proscribe bank employees and agents from engaging in any conduct that could be viewed as badges of fraud. Bank personnel must be made clearly aware of such procedures, and the financial institution must be able to confirm that its policies are strictly followed.[24]

What should a financial institution do if, during its conduct review, it discovers problematic conduct?

Although FFIs may otherwise be fully compliant with local regulatory provisions and practices, the U.S. government may still begin an investigation, as seen in Switzerland, Israel, and the Cayman Islands. Under its offshore compliance initiative, the DOJ evaluates the conduct of FFIs and their employees through the prism of U.S. criminal law, notwithstanding that the conduct occurred in a foreign banking environment in which practices and operations may be quite different from those in the U.S.

If potential badges of fraud are found during an account review, a detailed inquiry must follow. Whether the conduct was a result of bank practice, lack of internal controls, advice of a banker, or turning a blind eye to warning signs, it could lead to a determination of U.S. criminal culpability.

A detailed file review and interviews with relevant bank employees will be required to ascertain the facts relevant to the inquiry. Interviews with bank senior management will typically be necessary, even if the institution's senior ranks had no knowledge of the implicated employees' conduct. This type of inquiry must be conducted with full knowledge and consent of the employees' rights and confidentiality laws of the jurisdiction. Familiarity with U.S. civil and criminal law is also required to gain understanding of how prosecutors in the U.S. might view the conduct in question.

Discerning a banker's state of mind is often difficult. The banker's firsthand account of what transpired and why can provide the bank's counsel with far more meaningful information than can be gleaned from any file review. While an interview may confirm the worst about the underlying conduct, it could also uncover an innocent explanation. Either way, conduct cannot be evaluated in a vacuum or by merely relying on cryptic file notes. It is essential that potentially criminal conduct is reviewed to discern whether it was willful or merely inadvertent.[25]

If the conduct is confirmed to be problematic, the FFI might consider voluntarily disclosing it to the DOJ. The DOJ has announced that it is willing to reach fair resolutions with entities that come forward

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[24] *See,* with respect to financial institutions under ''classic'' FATCA and Model 2 IGAs, reg. sections 1.1471-4(c)(7), 1.1471-4(f)(3); *see also* FFI agreement, sections 8 and 9 (Rev. Proc. 2014-13, 2014-3 IRB 419). The IRS eased FATCA compliance with respect to some, but not all, certifications in Notice 2016-8, 2016-6 IRB 304. With respect to financial institutions covered under Model 1 IGAs, similar compliance and compliance remediation procedures ought to be adopted.

[25] *See supra* note 6.

in a timely manner to disclose all information on their potentially illegal activities and details of the individuals involved. Given these unique parameters, the decision of whether to disclose is best made with the input of counsel that is experienced in the Swiss bank program.

In summary, there are three essential elements to managing the enormous risks facing FFIs that opened, maintained, and/or exited undeclared U.S. accounts:

- First, the FFI must conduct an initial assessment to identify the number and nature of U.S.-related accounts.

- Second, the FFI must undertake a thorough and diligent internal investigation led by U.S. counsel along with supporting experts (for example, local legal counsel, forensic accountants with information technology expertise, and other supporting consultants) to define the nature and scope of the issue.

- Third, the FFI must determine how to proceed. At a minimum, the bank must retain qualified counsel to prevent these issues from arising in the future.

Conclusion

The growing international financial reporting regime now in place exposes international banking to an unprecedented level of transparency and scrutiny. The DOJ with IRS support, capitalizing on this new environment and armed with the reams of data obtained from endeavors against noncompliant U.S. accounts in Switzerland, has expanded its efforts against undisclosed U.S. accounts to the global arena. FFIs, particularly those in Asia, the Middle East, and the Caribbean, should examine their practices and risk exposure in these new circumstances to get ahead of any problems that may arise. ◆