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SPECIAL REPORTS

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Larry R. Kemm, William M. Sharp Sr., and William T. Harrison III are with the tax law firm Sharp Kemm PA, with offices in Tampa, Zurich, and San Francisco.

Through a series of carefully calculated maneuvers, the U.S. government has successfully brought pressure to bear on Liechtensteinische Landesbank AG (LLB) and its U.S. customers by forcing an eventual but seemingly certain turnover of U.S. account holders' bank documents. In particular, the U.S. authorities recently issued a request for administrative assistance to the Liechtenstein government that apparently will expose many U.S. taxpayers with millions of dollars in undeclared funds lodged in LLB. The U.S. deftly negotiated and implemented incremental anti-bank-secrecy measures over the past several years, including a qualified intermediary agreement, a tax information exchange agreement (thereby prompting follow-on enabling Liechtenstein legislation), an amendment to the enabling legislation, and an administrative assistance request. As a result, bank secrecy in Liechtenstein effectively no longer exists for U.S. taxpayers; therefore, a blanket disclosure of incriminating evidence of potential tax evasion and avoidance by U.S. account holders appears to be imminent.

The U.S. Department of Justice on May 11 issued a request for administrative assistance in the investigation of various U.S. taxpayers and others in connection with undeclared accounts at LLB. However, as chronicled below, many steps had to occur before the DOJ could successfully reach this point.

Liechtenstein-U.S. TIEA

Similar to its close neighbor Switzerland, Liechtenstein has long maintained strong bank secrecy rules to promise the ultimate in privacy and confidentiality relative to private banking activities. However, the bank secrecy barriers that shielded account holders from the expansive investigation of foreign tax authorities have been broken down.

The Principality of Liechtenstein signed a TIEA with the U.S. on December 8, 2008. This was the first TIEA ever entered into by Liechtenstein.[1] Similar to most TIEAs, the Liechtenstein-U.S. TIEA requires Liechtenstein to provide the U.S. with access to information needed to enforce U.S. tax laws, including information related to bank accounts in Liechtenstein. The requested information must be exchanged without regard to whether the conduct being investigated would constitute a crime under Liechtenstein law.[2] When the agreement was executed, however, Liechtenstein law precluded the disclosure of information included within the scope of the new Liechtenstein-U.S. TIEA. As a result, there was a significant catch: The Liechtenstein-U.S. TIEA could not go into effect until Liechtenstein changed its domestic laws to permit the disclosure of otherwise secret banking information. By the terms of the signed TIEA, Liechtenstein had approximately one year (until December 31, 2009) to enact such legislation.[3]

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[1]Several other TIEAs as well as bilateral income tax agreements have since been signed by Liechtenstein, including agreements with the U.K., Denmark, Japan, and Sweden.

[2]Tax evasion is not considered a crime in the Principality of Liechtenstein.

[3]For an analysis of the Liechtenstein-U.S. TIEA at the time of signing, see Joann M. Weiner, ''The New TIEA: A Christmas Gift to Liechtenstein,'' *Tax Notes Int'l,* Dec. 15, 2008, p. 831, *Doc 2008-26042*, or *2008 WTD 242-7.*

Liechtenstein's willingness to enter into the TIEA was not merely a gesture of goodwill or generosity. Indeed, Liechtenstein had a strong interest in cooperating with the U.S. because its status as a QI jurisdiction was set to expire at the end of 2008. Entering into the TIEA bought Liechtenstein time, as the Liechtenstein-U.S. TIEA provided that the treatment of Liechtenstein as an eligible QI jurisdiction would be provisionally extended until December 31, 2009. So long as Liechtenstein satisfied the conditions imposed by the signed TIEA (that is, principally enacting legislation that would enable Liechtenstein to carry out the terms of the TIEA), the U.S. agreed to renew its QI agreement with Liechtenstein.

In 2009 Liechtenstein's Parliament unanimously approved the TIEA with the U.S., and on September 16, 2009, passed the new Law on Administrative Assistance in Tax Matters, which would fulfill the legislative prerequisite for entry into force of the TIEA with the U.S. Based on the enactment of this legislation, the TIEA entered into force on January 1, 2010, with effect for 2009 and later tax years, and the QI status was extended an additional six years, until December 31, 2015. Thus, the TIEA would authorize requests only relating to tax years beginning in 2009 and would not reach back to earlier years.

Under the new Law on Administrative Assistance in Tax Matters, the Liechtenstein government is authorized to exchange information with the U.S. government on a justified request that contains the identity of the U.S. taxpayer and the underlying fact pattern. As necessary, a Liechtenstein court will determine whether any particular request is justified based on the information presented. As Liechtenstein's prime minister noted at the time, the new law helped establish Liechtenstein's position as a reliable treaty partner and furthered the goal of implementing OECD standards through agreements with other countries.

Amendments to Liechtenstein Domestic Law

Despite strides made through the successful entry into force of the TIEA on January 1, 2010 (with effect for tax years 2009 and later), the U.S. was left helpless in seeking information concerning potential tax violations committed by persons whose identity was not known to the U.S. government.

Nonetheless, a major step forward in U.S. enforcement efforts was recently achieved through the enactment of an amendment to Liechtenstein's Law on Administrative Assistance in Tax Matters. Specifically, by way of a report and proposed resolution presented to the Liechtenstein Parliament on March 20, 2012, the Liechtenstein Law on Administrative Assistance in Tax Matters was amended to:

- allow information exchange requests based on behavioral information when the specific identity of implicated taxpayers is not known; and
- expand the scope of years for which information that is the subject of a justified request can be provided.

The adoption of provisions that allow behavioral information requests is contained in new section 3 of article 7 of the amended legislation. Under this new provision, a request that relates to an identified group of unnamed taxpayers will be allowed if the request includes:

- a detailed description of the group, the pattern of behavior, and the facts that led to the request;
- the reasons to believe that the taxpayers belonging to the group have violated the tax laws, including an explanation of the applicable regulations; and
- the reasons for believing that the information requested is foreseeably relevant for assessing the tax compliance of taxpayers belonging to the group.

The expansion of the scope of years that are subject to a request for exchange of information is contained in article 30a of the amended legislation. Under amended article 30a, information may be provided under the TIEA for tax years beginning on or after January 1, 2001 (as opposed to the 2009 and later tax years generally covered by the TIEA), but only if the request is made by the U.S. between May 1, 2012, and April 30, 2013.[4]

Once again, it is unlikely that the Liechtenstein government adopted these legislative amendments out of goodwill. To the contrary, the report presented to the Liechtenstein Parliament in support of the legislative amendments refers to the intensification of efforts on the part of the U.S. government to indict Swiss banks and their employees for their role in facilitating U.S. tax violations. The report suggests that it is necessary to provide a legal basis for the exchange of information going back to as early as 2001 to protect potentially affected financial institutions and intermediaries from any threat of imminent indictment and the existential consequences that may follow.

Request for Assistance

Shortly after Liechtenstein amended its domestic law to allow behavioral pattern requests, on or around May 11, 2012, the DOJ issued its request for administrative assistance related to its investigation of U.S. taxpayers and others connected with undeclared accounts at LLB. The request specifically refers to article 7, section 3 and article 30a of the Law on Administrative Assistance in Tax Matters to support the requested production of documents. The request targets individual U.S. taxpayers (citizens and lawful permanent residents,

[4]For pre-2009 tax years, the U.S. already can obtain information regarding criminal matters under the existing Liechtenstein-U.S. mutual legal assistance treaty.

but no reference is made to individuals who are treated as residents under the substantial presence test) who beneficially owned undeclared accounts at LLB and violated U.S. law by failing to report and pay taxes on income earned in such accounts, as well as third-party advisers who aided and abetted, or conspired with, U.S. taxpayers in committing criminal offenses. It is not clear why the request was made by the DOJ (in contrast to most requests for exchange of tax information that are typically made by the Treasury Department), but it may relate to the criminal-focused nature of the request.

The account records sought by the U.S. in the request are divided into two groups. The Group I accounts include any accounts open at any time on or after January 1, 2004, that were beneficially owned (in whole or in part) by a U.S. taxpayer. The Group II accounts include any accounts open at any time on or after January 1, 2004, that were held in the name of a non-U.S. corporation, foundation, trust, or other legal entity, but beneficially owned (at least in part) by a U.S. taxpayer. An account is included in either Group I or Group II only if the account had a year-end account balance of at least $500,000 at any time after January 1, 2004. Accounts that were closed on or before December 31, 2003, are expressly excluded from the request, as are accounts held in Switzerland through LLB's Swiss subsidiary (although it is fair to say that the Swiss subsidiary is far from immunized given the U.S. government's continued investigation of several Swiss-based financial institutions).

To support its request for assistance, the U.S. identifies seven principal sources of information that purportedly lead to a ''strong suspicion of noncompliance'' with U.S. law. Interestingly, the first three items on the list are statistical information provided by LLB regarding accounts maintained at LLB (both in Liechtenstein and in Switzerland), internal LLB documents concerning the management of its cross-border business, and a sample of 45 redacted client files provided by LLB. Thus, the U.S. apparently was able to persuade LLB to provide information concerning accounts held and practices conducted at LLB that the U.S. government then turned into a formal request for exchange of information. Among the other principal sources of information leading to a strong suspicion of noncompliance are details obtained through the 2009 and 2011 offshore voluntary disclosure programs administered by the IRS, as well as information developed in the investigation of a Swiss financial adviser who assisted U.S. taxpayers in opening undeclared accounts.

The statistical data provided by LLB showed that fewer than 2 percent of all U.S. taxpayers with account relationships at the bank provided a Form W-9, leading the DOJ to conclude that many U.S. taxpayers who beneficially owned LLB accounts filed false Forms 1040 that failed to report income earned in their LLB accounts, and failed to timely file foreign bank account reports. Moreover, the redacted bank files and statistical information provided by LLB also revealed that many accounts:

- used ''code word agreements'' to minimize the use of actual taxpayer names;
- implemented agreements to hold mail to ensure that evidence remained outside the U.S.; and
- expressly instructed LLB not to disclose the taxpayer's name to the IRS.

The DOJ notes that these features readily identified such LLB accounts as accounts that were not reported by the U.S. taxpayers to the IRS. Finally, the DOJ pointed to accounts held through offshore legal structures as affirmative steps taken by U.S. taxpayers to establish and maintain the structures for the purpose of concealing the existence of their accounts from the IRS.

Based on these factors, the DOJ developed a strong suspicion that many U.S. taxpayers have not complied with U.S. law. Therefore, the DOJ request seeks administrative assistance in obtaining extensive documentation concerning accounts maintained at LLB, including documents completed to open accounts, documents establishing the identity of any beneficial owner of an account, documents reflecting any transaction activity in an account, and documents reflecting correspondence or communications among the bank, the beneficial owners, and any third-party advisers.

According to letters sent by LLB to U.S. account holders, the bank was required to provide information responsive to the mutual assistance request to the Liechtenstein Tax Authority within 14 days of the May 16, 2012, date of service of the request letter received from the Liechtenstein Tax Authority. The Liechtenstein Tax Authority will thereafter issue its final order upon completion of the review and investigation of the information provided. The account holder then has only 14 days within which to file an appeal under Liechtenstein law to contest the final order of the Liechtenstein Tax Authority. To ensure prompt receipt of notice concerning the decision of the Liechtenstein Tax Authority, the account holder is encouraged to provide details of a domestic agent in Liechtenstein who is authorized to accept service on behalf of the account holder. Given the timeline outlined in letters sent by LLB, it is possible that documents for many of the affected account holders have already been provided to U.S. authorities.

Implications of Filing an Appeal

In the event that an appeal is filed by a U.S. account holder under Liechtenstein law to contest the final order of the Liechtenstein Tax Authority, the account holder is required under U.S. law (18 U.S.C. section 3506) to serve notice of such appeal on the U.S. attorney general. This notice must be given at the time of the appeal. Importantly, the IRS recently announced that a U.S. taxpayer who files an appeal in opposition

to the disclosure of foreign account documents will be *ineligible* to participate in the ongoing 2012 offshore voluntary disclosure program.[5] Accordingly, a U.S. taxpayer who has received notice of a final order by the Liechtenstein Tax Authority that documents will be turned over is put in a highly difficult position, as explained below.

If the U.S. account holder appeals the turnover of LLB account documents but does not promptly serve notice on the U.S. attorney general under 18 U.S.C. section 3506 and does not prevail in the appeal, the U.S. account holder will have lost the opportunity to pursue remedial relief under the IRS voluntary disclosure program and may also be subject to criminal prosecution. Similarly, if the account holder appeals the turnover of LLB account documents and indeed complies with 18 U.S.C. section 3506 by serving notice on the U.S. attorney general (an unlikely but possible scenario), such person will ultimately be investigated by U.S. tax authorities, and therefore would be well advised to pursue a voluntary disclosure (thereby negating the objective of filing an appeal against the turnover of documents in the first place). Finally, if the U.S. account holder does not appeal the turnover, then the LLB account documents will most certainly be disclosed to the U.S. authorities, thereby subjecting the U.S. account holder to both potential criminal prosecution as well as significant civil penalties on top of huge back tax deficiencies.

The only possible ''successful'' outcome from the perspective of the recalcitrant U.S. account holder would be to successfully appeal the turnover of LLB account documents without serving notice on the U.S. attorney general under 18 U.S.C. section 3506. This is problematic, however, because a professional adviser could not knowingly participate in the representation of such a client without becoming complicit in the failure to abide by the U.S. attorney general notice requirement. For this reason, few professional advisers would choose to represent the U.S. account holder in pursuing such a strategy, particularly given that such client's ''secret'' banking information may very well be turned in under the U.S. Foreign Account Tax Compliance Act, the disclosure provisions of which go into effect in 2014.

Moreover, it is highly unlikely except in the rarest of circumstances that the Liechtenstein Tax Authority or a Liechtenstein judicial forum would overturn a decision to disclose account documents to the U.S. authorities (LLB has already stated that it will not challenge the final order for the grant of mutual assistance by the Liechtenstein Tax Authority). Thus, a U.S. account holder's chances of successfully appealing a final order to disclose account documents are highly improbable.

As a result, the account holder effectively has no choice but to pursue a voluntary disclosure with the IRS under the 2012 offshore voluntary disclosure program to effectively avoid exposure for criminal prosecution and to minimize the potential civil liabilities. Once the administrative assistance is granted and the turnover of the LLB information to the U.S. government occurs, affected taxpayers will no longer be in a position to meet the timeliness requirement set forth in the voluntary disclosure program.

As an aside, the U.S. government's focus in the administrative request on investigating whether third-party advisers aided and abetted, or conspired with, LLB-connected U.S. taxpayers in committing criminal offenses could arguably undercut efforts to bring U.S. taxpayers voluntarily into compliance. In particular, many third-party advisers who have relationships with U.S. account holders and could encourage them to take steps toward voluntary U.S. tax compliance may be hesitant to do so out of fear of potential repercussions to third-party advisers. Although seeking criminal charges against third-party advisers may deter other advisers from engaging in similar conduct in the future, such third-party advisers may never be prosecuted because of jurisdictional limitations.

Moreover, similar conduct by third-party advisers in the future will be more difficult in any event because of the myriad weapons available to the U.S. government through QI agreements, TIEAs, and FATCA. Thus, query whether the U.S. government's announced intention to pursue third-party advisers is the best course of action to accomplish the overriding objective of tax compliance and collection of tax revenues through LLB-connected U.S. taxpayers participating in the offshore voluntary disclosure program.

Conclusion

In the end, the DOJ's request for administrative assistance from Liechtenstein in connection with LLB is not surprising given the continuing efforts of the U.S. government over the past several years to combat tax evasion through the use of offshore entities and accounts putatively sheltered by bank secrecy. What is interesting, however, is the magnitude of weapons the U.S. government has amassed to facilitate the further eradication of global offshore abuses. This was evident in the pressure brought to bear on Liechtenstein in reaching the point of cooperation on this particular request for assistance. In the future, no jurisdiction can provide an assured safe haven for such abuses, at least with respect to stable countries where one might be willing to park significant assets. ◆

[5] *See* FAQ 21 of the 2012 offshore voluntary disclosure program frequently asked questions and answers released by the IRS on June 26, 2012.