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SPECIAL REPORTS

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On August 29, the United States Department of Justice and the Swiss Federal Department of Finance executed a joint statement announcing a compliance program designed to resolve the five-year-old DOJ/IRS-initiated war with the Swiss banking community over Swiss bank secrecy.[1] The joint statement and its complex and detailed initiative, called the Program for Non-Prosecution Agreements or Non-Target Letters for Swiss Banks (the program), provide a path by which all Swiss banks not currently under DOJ criminal investigation may bring closure to U.S. criminal legal exposure for having maintained Swiss bank accounts on behalf of noncompliant U.S. taxpayers.

The program represents the first resolution of its kind as directed to a specific business sector of a specific country, and it underscores the importance of Swiss-U.S. trade, investment, and travel given that these sectors have suffered to some degree as a result of this protracted dispute. U.S. Attorney General Eric Holder emphasized that the new accord will strengthen ''our partnership with the Swiss Government.''[2]

One could argue that the program should have been issued in a more expedited manner, and arguably as early as a couple of years ago. However, no one really knows what took place at the bargaining table and the many obstacles faced by those involved in the protracted dispute, let alone the incredible complexity of the many underlying issues. While the final terms and conditions of the program may represent a practical approach to enable all eligible Swiss banks to resolve any U.S. legal exposure stemming from the bank secrecy dispute, some enhancements and clarifications to the program should be urgently adopted in order to carry out the joint statement's policy announcements and the fundamental objects of the program. Time is of the essence given that eligible Swiss banks must notify their own government of their designated program categories by December 9, 2013, as further discussed below.

Overview of the Program

The program provides a blueprint with many conditions and disclosure requirements for a participating Swiss bank to resolve its criminal legal entanglements with the U.S. legal and tax system. Interestingly, the program adopts in a thematic context the principles of

[1] *See* Press Release, Department of Justice, United States and Switzerland Issue Joint Statement Regarding Tax Evasion Investigations (Aug. 29, 2013), *available at* http://www.justice.gov/opa/pr/2013/August/13-tax-975.html. Linked to the DOJ press release is a copy of the signed Joint Statement (herein ''the joint statement'') as well as the corresponding Program for Non-Prosecution Agreements or Non-Target Letters for Swiss Banks (herein ''the program''). On August 30, 2013, the Swiss government posted on its website a summary of the joint statement and the program, as well as a new unilateral Swiss section describing the parameters in the form of a model authorization for Swiss banks to participate in the program, *available at* http://www.news.admin.ch/NSBSubscriber/message/attachments/31822.pdf.

[2] *See* Press Release, Department of Justice, *supra* note 1.

the traditional IRS offshore voluntary disclosure program that historically is directed to American individuals and companies having noncompliant offshore investments.[3] From the beginning of the 2009 IRS voluntary disclosure program through August 2013, more than 38,000 participants have taken advantage of the various iterations of the IRS voluntary disclosure program to resolve criminal as well as civil tax exposure with the U.S.[4] Similarly, it is fair to state that the U.S. and Swiss governments have targeted a high level of Swiss bank participation in the program, in that the joint statement clearly indicates a commitment of the Swiss government to encourage widespread participation among its eligible banks.[5]

The new initiative is not obligatory: The three separately defined categories of Swiss banks may freely elect to participate in the program. Nonetheless, the Swiss government will strongly encourage its banks to participate in the program to finally resolve the U.S. assault on the Swiss banking system — and for sound reasoning. The benefits accruing to the Swiss banking system and to participating Swiss banks are clear: Such banks will no longer be possible targets of the U.S. criminal legal system, and they will walk away with a clean bill of health. This also will end the hemorrhaging of millions of francs of resources that the Swiss government and many of its regulated banks have dedicated to this dispute over the past several years. Finally, and perhaps most important, the global private banking and investment community should have an elevated confidence in the historically preeminent Swiss private banking brand — the number one private banking sector in the world.[6]

Impact of the Joint Statement

Although the program contains the detailed guidance regarding its terms and conditions, the commentary set forth in the joint statement may very well have an impact on how the program is interpreted and administered and provide policy guidance to eligible Swiss banks considering participation in the program.

The joint statement was signed at the highest levels of both governments — the U.S. deputy attorney general on behalf of the DOJ, and the Swiss ambassador to the United States on behalf of the Swiss Federal Department of Finance. As noted above, the program provides a path for eligible banks to obtain resolution of their status regarding DOJ offshore administration and enforcement. Further, the program represents a vehicle by which such banks may ''assist'' the DOJ with its law enforcement efforts. A critical question, however, is whether the U.S. will administer the program as a prescriptive and inflexible administrative regime (as many have criticized has been the case with the various IRS offshore voluntary disclosure programs), or whether it will be handled in a more flexible, equitable, and practical manner.

The joint statement clarifies that the program is not available to individuals or those Swiss banks to which the DOJ Tax Division has authorized a formal criminal investigation. As discussed below, however, the program's definition of eligible participants is even narrower than this general policy statement, and given the comments discussed below, the program's criteria in certain areas, especially in Category 4, merit immediate review and clarification.

The Swiss government also makes insightful comments and policy commitments in the joint statement, including a welcoming of the efforts of the DOJ to provide this compliance initiative, an intention to ''draw the attention'' of Swiss banks to the program, and to encourage those banks to ''consider participating'' in the new initiative. The Swiss government also represents that the Swiss Federal Council will use its best efforts to allow Swiss banks to cooperate with the DOJ so long as its cooperation is within the existing legal framework of Swiss law. Of key importance, the Swiss government even goes further by representing that applicable Swiss law ''will permit effective participation'' by participating Swiss banks as mandated in the program.[7] The upshot of these comments is that the Swiss government is keen on seeing the program followed by all eligible Swiss banks.

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[3]For a background discussion of the IRS offshore voluntary disclosure programs, see William M. Sharp Sr., Larry R. Kemm, and William T. Harrison III, ''The 2012 Offshore Voluntary Disclosure Program: Analysis, Insight, and Intrigue,'' *Tax Notes Int'l*, Aug. 13, 2012, p. 681; William M. Sharp Sr., Larry R. Kemm, and Andrea D. de Cortes, ''The 2011 Voluntary Disclosure Initiative: Truly the 'Last, Best Chance'?'' *Tax Notes Int'l*, Mar. 14, 2011, p. 865; William M. Sharp Sr. and Larry R. Kemm, ''IRS Guidance on Offshore Voluntary Disclosures: Further Refinements,'' *Tax Notes Int'l*, May 18, 2009, p. 595; and William M. Sharp Sr. and Larry R. Kemm, ''News Analysis: IRS Reduces Penalties on Offshore Voluntary Disclosures,'' *Tax Notes Int'l*, Apr. 6, 2009, p. 7.

[4]IRS News Release IR-2012-89 (Nov. 7, 2012).

[5]The joint statement, *supra* note 1, at para. 2.

[6]According to the Swiss Bankers Association, which has approximately 350 member banks, Switzerland is the leading private banking jurisdiction in the world, holding a 25.9 percent share of worldwide assets under management in 2012. Hong Kong and Singapore held a 14.1 percent market share, with the Channel Islands and Dublin following tied with the Caribbean and Panama at 12.9 percent, and thereafter the U.K. at 10.6 percent, the U.S. at 8.2 percent, and finally Luxembourg at 7.1 percent (with others contributing the final 8.2 percent). Interestingly, of the CHF 5.6 trillion assets under management in Switzerland

(Footnote continued in next column.)

during 2012, 51 percent represented holdings of non-Swiss foreign customers and the remaining 49 percent is held by domestic customers. Swiss Bankers Association, The Financial Centre: Engine of the Swiss Economy (July 2013), *available at* http://www.swissbanking.org/en/shop_popup.htm?ID=999926.

[7]The joint statement, *supra* note 1, at para. 2.

Another key element of the joint statement that is not addressed in the program is the reference of the Swiss Financial Market Supervisory Authority, commonly known as FINMA. The joint statement notes that FINMA ''intends to encourage,'' to the extent of its supervisory powers, all Swiss banks to transmit letters to U.S. persons or entities with U.S.-related accounts (as defined in the program) at those Swiss banks to inform them of this new initiative and also to draw their attention to the IRS offshore voluntary disclosure program.[8]

As discussed below, this statement is of particular importance in the context of mitigating penalty exposure under the program: The extent to which noncompliant U.S. account holders of Swiss banks become compliant will directly reduce the potential penalty exposure of certain Swiss banks (which are deemed ''Category 2'' participants). Accordingly, it is not just out of the Swiss government's generosity and goodness to provide this soft mandate to Swiss banks to encourage this comprehensive customer communication, but it is most certainly intended to mitigate penalty exposure as described in the program.

Even though the joint statement and the program represent an unprecedented and comprehensive initiative that will affect virtually all Swiss banks, the Swiss government nonetheless has stuck to its guns to clarify in the joint statement that Switzerland will process treaty requests strictly in accordance with the Convention between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, signed in Washington on October 2, 1996, and the Protocol Amending the Convention, signed in Washington on September 23, 2009, but only ''if and when it is in force and applicable.''[9] This is a crucial component of the new initiative that will dictate the program's level of effectiveness, because the protocol that was approved by Switzerland in April 2009 and then signed by both parties on September 23, 2009, still remains stalled in the U.S. Senate Foreign Relations Committee. Until the protocol is approved by the Senate and then formally ratified, the degree to which American client names, identifying data, and identifying information may pass from the Swiss government to the IRS by way of a treaty request will be extremely limited, as explained below.[10]

It is also interesting to note that the joint statement includes a commitment by the Swiss government to handle all treaty requests on an ''expedited basis,'' and this will include providing additional personnel and other resources to process treaty requests.[11] These statements indicate that the U.S. government is most certainly preparing to launch a series of requests under the treaty presumably on a ''behavioral pattern'' basis and presumably on the basis that the limiting ''tax fraud or the like'' standard under the 1996 treaty will have been eradicated upon the ratification by the U.S. of the 2009 protocol. This remains to be seen because no apparent progress toward approval of the protocol appears to be in the works at the Senate Foreign Relations Committee level.

Finally, the joint statement acknowledges the high level of personal data and privacy protection for all individuals in accordance with applicable law, and both governments agree that any personal data should only be used for law enforcement purposes including regulatory action within the U.S. The joint statement also includes a requirement that personal data should be retained only ''for so long as necessary for these purposes.''[12]

Given the earlier representation of the Swiss government to allow the passing of key information and documentation, this particular provision upholds confidentiality concerns expressed by the Swiss government over the past few years, as both parties agree that such data is to be protected under applicable law. But the true meaning of this confidentiality commitment needs to be fully understood: In appropriate circumstances the IRS and DOJ will most certainly share information originating from Switzerland with appropriate U.S. governmental agencies to further U.S. law enforcement efforts. Thus, the information obtained by the IRS via treaty request may be readily transmitted to the DOJ for review and potential follow-on criminal investigation and prosecution of U.S. Swiss banking customers turned in. This represents a hazard to all noncompliant American account holders maintaining undeclared Swiss bank accounts.

One aspect of the joint statement and the program that merits mention is the conspicuous absence of any reference to implications for individual bankers at the Swiss banks that participate in the program. In recent years, some Swiss bankers who have solicited or assisted Americans in maintaining noncompliant Swiss bank accounts have been arrested or detained when traveling to the U.S., and in some situations indicted on criminal charges.[13] These developments have understandably created fear in Swiss bankers and other Swiss advisers to avoid international travel, particularly to the U.S. For this reason, it would have been helpful if the

[8]*Id.* at para. 3.

[9]*Id.* at para. 4.

[10]*See* William M. Sharp Sr., ''Navigating Offshore Hazards: An Update,'' *Tax Notes Int'l*, May 13, 2013, p. 695; and Walter H. Boss and William M. Sharp Sr., ''The Swiss-U.S. 'Turnover' Ground Rules: A Technical Update,'' *Tax Notes Int'l*, Nov. 7, 2011, p. 423.

[11]The joint statement, *supra* note 1, at para. 4.

[12]*Id.* at para. 5.

[13]*See* http://www.federaltaxcrimes.blogspot.com/search/label/Offshore%20Account%20Enablers.

joint statement or the program expressly provided a path for the benefit of those Swiss bankers and advisers that have been associated with a Swiss bank that participates in the program. Rather, the only guidance is reflected in the DOJ press release concerning the program, which states that ''bank employees who are concerned about whether they have potential criminal liability should contact the department's Tax Division or the prosecutors handling their case if they wish to seek resolution.''[14]

Eligibility

Eligibility for Swiss banks electing to participate in the program is based on certain enumerated conditions, but in general most Swiss banking institutions that have licenses for depository and custodial services will be eligible. The definition of an eligible Swiss bank is based on the same term as used in the FATCA agreement definition of a ''Swiss Financial Institution.'' However, in the program, so-called investment entities are excluded from eligibility, as are ''Specific Insurance Companies'' that do not independently meet the definition of either a ''Custodial Institution'' or a ''Depository Institution.''[15]

Furthermore, even if a financial institution falls within the definition of a Swiss bank, the particular institution will not be eligible if the DOJ's Tax Division has authorized a formal criminal investigation of a Swiss bank's operations, as of August 29, 2013.[16] The program states that all of these banks, known as Category 1 banks, either have already been notified or will be so notified through such banks' counsel by certified mail issued ''in conjunction with'' the announcement of this program (*that is*, presumably on August 29, 2013).[17]

Based on the DOJ press release announcement of the program and various press reports, the DOJ is actively investigating the Swiss-based activities of about 15 financial institutions, and the list of Swiss banks that are currently under formal DOJ criminal investigation will likely expand given the above reference to certified mail issued on August 29.[18]

Assuming Eligibility, Then What?

Many Swiss banks that have a tenuous connection to the U.S., including a de minimis number of U.S. customers, might question why to bother with participating in the program. Although each case must be reviewed on its specific facts and circumstances, in general, any bank that has historical noncompliant American customers, and even those banks whose U.S. customers have been ''exited,'' should strongly consider participating in the program as a way to resolve any lingering disputes and obtain a seal of approval from the U.S. government.

Swiss banks must keep in mind that the Foreign Account Tax Compliance Act[19] is now spreading like wildfire as many other countries are considering adopting their own versions of FATCA, and, as a result, the level of worldwide disclosure is going to be even more pervasive. Furthermore, the ongoing Swiss-related investigations by the DOJ and IRS regarding offshore enforcement and bank secrecy are anticipated to continue for many years. The program represents a practical means for Swiss banks to resolve this exposure and avoid years of uncertainty, potentially dedicating vast resources to ongoing investigations, and perhaps, in the end less advantageous settlements.

The threshold question for any Swiss bank contemplating participation in the program is whether it would be treated as a Category 2, Category 3, or Category 4 bank. As noted above, because a Category 1 bank that is under formal criminal investigation (and has been so notified by the DOJ) is not eligible to participate in the program, the relevant categories are limited to Category 2, Category 3, and Category 4.[20] The category in which a given Swiss bank falls will substantially drive the nature and extent of the administrative process with the DOJ, and also materially affect the resolution of the case.

For example, a Swiss bank that has a de minimis number of U.S. clients within the ''applicable period''[21] may not only be in a position to avoid any monetary penalties but also may be in a position to have any tax-related offenses excused without a high level of investigation and review (although some modifications to the program need to be made to achieve this result, as discussed below). On the other hand, a Swiss bank that has ''reason to believe'' that it ''may have'' committed tax-related offenses or what are known as monetary transaction offenses will be in the less enviable position

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[14] Press Release, Department of Justice, *supra* note 1.

[15] The program, *supra* note 1, at para. I.B.4.

[16] *Id.* at para. I.A.

[17] *Id.*

[18] *See* David Voreacos, ''Secret Swiss Accounts Said No Longer Safe for Tax Dodging,'' Bloomberg, Sept. 8, 2013, *available at* http://www.bloomberg.com/news/2013-09-08/secret-accounts-said-no-longer-safe-for-tax-dodging.html; John Letzing, ''Private Swiss Bank Says It Is Under Investigation in U.S.,'' *Wall St. J.*, Sept. 11, 2013, *available at* http://www.online.wsj.com (search ''Rahn & Bodmer''); and Laura Saunders, ''Offshore Accounts: No Place to Hide?'' *Wall St. J.*, Sept. 20, 2013, *available at* http://www.online.wsj.com (search ''No Place to Hide'').

[19] Hiring Incentives to Restore Employment Act of 2010, P. L. 111-147, section 501, 124 Stat. 71, 97-106 (2010).

[20] The program, *supra* note 1, at para. I.A.

[21] Defined by the program as beginning on August 1, 2008, and running through various later periods but generally through December 31, 2014. *See id.* at para. I.B.6.

of resolving the case through the payment of potentially substantial penalties, as described below.[22] Finally, for those Swiss banks that would not qualify as a Category 4 bank because of a more than de minimis number of clients residing outside of Switzerland and EU member states but that did not otherwise commit tax-related offenses or monetary transaction offenses that would be present in the case of a Category 2 bank, then subject to many terms and conditions, such banks should be in a position to obtain a non-target letter and avoid penalty exposure as a Category 3 bank.

Following is a practical summary of key considerations in reviewing an eligible Swiss bank's participation in the program from the perspective of determining the appropriate category. In order to determine the appropriate category of an eligible Swiss bank, and then to develop and present the case to the DOJ, which undoubtedly will enlist substantial support from the IRS, great legal care and due diligence must be exercised by both U.S. legal counsel and Swiss legal counsel given the many Swiss legal issues that will arise in connection with participation in the program. Because of the December 31, 2013, DOJ filing deadline for Category 2 banks (and even an earlier December 9, 2013, deadline for Swiss banks to inform FINMA of their designated categories),[23] all eligible Swiss banks need to promptly begin this due diligence review process with U.S. and Swiss legal counsel.

Category 4 Bank

Clearly the most favorable category under the program is Category 4, which represents a ''Deemed Compliant Financial Institution'' as a ''Financial Institution with Local Client Base'' under the Swiss-U.S. intergovernmental ''Model II'' FATCA agreement.[24] One of the local client base requirements is that at least 98 percent of the accounts by value provided by the Swiss bank must be held by residents of Switzerland or EU member states (that is, the FATCA de miminis rule).[25] The program states that this requirement must be applied ''as if the FATCA agreement were in force during the Applicable Period,'' which begins on August 1, 2008.[26] The FATCA agreement further requires that, beginning on January 1, 2014, the Swiss bank does not provide any accounts to U.S. persons who are not Swiss residents.[27]

If the language in the program is interpreted to move the January 1, 2014, FATCA date back to August 1, 2008, which the plain language of the program and the FATCA agreement seems to prescribe, then any Swiss bank that would otherwise qualify for Category 4 but had a single U.S. account relationship (other than with a Swiss resident) on or after August 1, 2008, would be automatically disqualified from Category 4 treatment. This certainly could not be the intended result because it would undermine the intent of having a 2 percent de minimis rule regarding a limited in substance U.S. customer base. For example, any given Category 4 Swiss bank likely had at least one U.S. customer who was not a Swiss resident (though well under the 2 percent threshold) on or after August 1, 2008. Thus, if this strict ''retroactive'' application of the rule were to apply, virtually no Swiss bank that is otherwise treated as a ''deemed-compliant financial institution'' that constitutes a ''financial institution with local client base'' under the FATCA agreement would be able to qualify as a Category 4 bank.

As a further condition of the program, the 2 percent FATCA de minimis test must be satisfied as of December 31, 2009, as well as the date of the announcement of the program. These expressly stated testing dates appear to leave open the possibility that a bank could have satisfied the de minimis rule on December 31, 2009, and despite a spike of American account holders above the 2 percent threshold during the intervening years, would nevertheless qualify as a Category 4 bank if the American account holders were later ''exited'' to fall within the 2 percent threshold as of August 29, 2013. Surely this is not an intended scenario for any Swiss bank qualifying under Category 4.

If a Swiss bank qualifies as a Category 4 bank, it is precluded from participation as either a Category 3 or Category 2 bank (nor would it want to participate in either of those categories, which are generally less favorable). Nevertheless, the question arises whether a bank that otherwise satisfies the 2 percent de minimis test would still qualify as a Category 4 bank if there is any reason to believe that the Swiss bank or any of its

[22] *Id.* at para. II.A, H.

[23] According to a FINMA release, all participating Swiss banks are required to advise FINMA of its status by December 9, 2013. ''Das US-Programmzur Bereinigung des Steuerstreits der Schweizer Bankenmit den Vereinigten Staaten'' (in German), FINMA Newsletter 50 (Swiss Financial Market Supervisory Authority, Bern, Switzerland), Aug. 30, 2013, at 3 (on file with author) (hereinafter FINMA Newsletter 50). *See* http://www.finma.ch/d/finma/publikationen/Lists/ListMitteilungen/Attachments/67/finma-mitteilung-50-2013-d.pdf.

[24] *See* Agreement Between the United States of America and Switzerland for Cooperation to Facilitate the Implementation of FATCA, Annex II, para. II A.1 (hereinafter ''the FATCA agreement''). As noted earlier, assuming a Category 4 bank satisfies all conditions of the program, the DOJ may issue a non-target letter to the bank. For purposes of making Category 4 determinations under the program, the requirement that a Swiss bank be a ''Deemed Compliant Financial Institution'' as a ''Financial Institution with Local Client Base'' should best be viewed as a set of qualifications indicating that the Swiss bank poses a low risk of noncompliance, and not as a requirement that the Swiss bank actually pursue treatment as a ''Deemed Compliant Financial Institution'' for FATCA purposes.

[25] *Id.* at II.A.1.e).

[26] The program, *supra* note 1, at para. IV.A.2.

[27] FATCA agreement, *supra* note 24, at Annex II, para. II.A.1.f).

representatives have committed tax-related offenses under titles 18 or 26, or monetary transactions offenses under sections 5314 or 5322 of title 31, in connection with undeclared U.S.-related accounts held by the Swiss bank during the applicable period. Curiously, both Category 2 and Category 3 impose implications or preconditions, respectively, to whether there is reason to believe any such offenses have been committed or whether any such offenses have in fact been committed. Yet the program contains no express statement about whether a bank that otherwise qualifies as a Category 4 bank might be disqualified from such category upon discovery of any evidence that tax-related or monetary transactions offenses may have occurred, other than a reference at the end of Paragraph IV.E. of the program that the DOJ may decline to issue a non-target letter if it ''demonstrates criminal culpability'' by the Swiss bank.

Accordingly, the apparent implication is that even if some of those offenses might have occurred, because of the de minimis U.S. clientele, the Category 4 status should nevertheless apply. If that is not the intended implication, then practically speaking most potential candidates for Category 4 would have a difficult time satisfying the Category 4 requirements where, for example, one aggressive relationship manager may have crossed the line with a few noncompliant U.S. customers but otherwise the bank has no other potential title 18, 26, or 31 infractions. Ideally, Category 4 should be clarified to state that if the 2 percent de minimis test is satisfied, any potential ''offenses'' should not be taken into account given the limited U.S. clientele of the bank.[28]

Another practical hurdle confronting potential Category 4 bank participants in the program is the sheer enormity of work required in a relatively short period to assemble, analyze, and package the quantitative data. For example, the very task of computing the percentages as set forth in the ''Deemed-Compliant Financial Institution with Local Client Base'' category is very difficult because many ''local'' Swiss banks did not historically accumulate this data, and to go back as of August 1, 2008, to reconstruct this information is materially burdensome to any prospective Category 4 bank because many thousands of client relationships would need to be reviewed. For this reason, hopefully a more practical rule will be adopted that allows Category 4 banks to qualify based on existing data, and the bank will not be required to go back and contact many thousands of customers simply to prove a negative, and that a representation could be appropriate as a part of the disclosure indicating that to the best of the bank's knowledge the historic U.S. customer base is calculated in a reasonable manner and that, in any event, the Swiss bank does not provide any accounts to U.S. persons beginning on January 1, 2014.

Another important consideration is the conundrum created by the FATCA deemed-compliant financial institutions requirement that the Swiss bank must not have policies or practices that discriminate against handling American customers' Swiss banking matters when the Americans reside in Switzerland.[29] This represents a practical dilemma for prospective Category 4 Swiss banks because given the pressure imposed by the DOJ and IRS on the Swiss banking community for the past several years, many Swiss banks have exited all American clients, including those residing in Switzerland. The DOJ should clarify the scope of this particular provision because Swiss banks that choose not to bank Americans should have the right to do so, given the complexity of the American legal system, ranging from U.S. tax law, securities law, and other complicated considerations applicable to American account holders wherever they may be situated. Furthermore, any ''nondiscrimination'' position, if adopted, should be applicable only on or after January 1, 2014.

Category 3 Bank

A Category 3 bank is any Swiss bank (other than a Category 1 or Category 4 bank) that has not committed any tax-related offenses under titles 18 or 26, or monetary transactions offenses under sections 5314 or 5322 of title 31, in connection with undeclared U.S.-related accounts held by the Swiss bank during the applicable period.[30] Assuming that on the conclusion of an independent internal investigation conducted by an ''independent examiner,'' the Swiss bank and the independent examiner sufficiently verify and provide information required by the program, the DOJ Tax Division may provide a non-target letter to the Swiss bank. Such a letter represents an acknowledgement by the Tax Division that the Swiss bank is not the target of a criminal investigation. Moreover, similar to a Category 4 bank but unlike a Category 2 bank, a qualifying Category 3 bank is not subject to monetary penalties or fines of any kind.

One of the key criteria for qualifying under Category 3 is that the Swiss bank and the independent

[28]On September 21, 2013, the assistant attorney general for the tax division of the DOJ publicly commented that otherwise qualifying Category 4 banks are not safe from criminal prosecution because the U.S. government has reserved the right to prosecute banks otherwise qualifying for Category 4 depending on the level of criminal culpability. Although the assistant attorney general stated that ''[t]here are no de minimis provisions in here,'' she apparently was speaking about the ''criminal culpability'' language contained in IV.E. of the program, as discussed above. Although not entirely clear from her comments, one interpretation of these statements is that a Category 4 bank that had potential wrongful acts needs to carefully consider such acts through the lens of titles 18, 26, and 31 as potential offenses on the one hand versus excusable and non-willful or inadvertent actions on the other. Related coverage: p. 1297 of this issue.

[29]FATCA agreement, Annex II, para. II.A.1.j).

[30]The program, para. III.A.

examiner ''verify that the Swiss Bank has an effective compliance program, accompanied by a description of the compliance program.''[31] The program provides no guidelines or standards for what constitutes an ''effective compliance program.'' Thus, it is incumbent on the Swiss bank to make this qualitative determination before choosing to request a non-target letter as a Category 3 bank. Presumably, this requires detailed procedures to adequately vet whether an account holder has status as a U.S. citizen or resident, to further document that appropriate tax representations have been obtained (for example, forms W-9, W-8BEN, and so forth), and to demonstrate that the U.S. tax withholding requirements are accurately fulfilled.

More importantly, the Swiss bank must be confident in representing that it ''has not committed'' any tax-related offenses or monetary transactions offenses.[32] This requirement is set forth as an absolute requirement in contrast to the less stringent standard of having ''reason to believe'' it may have committed such offenses (as applicable in the case of Category 2 as discussed below). The apparent import of this determination is that the Tax Division may deny the bank's request for a non-target letter if there have been *any* tax-related or monetary transactions offenses committed during the applicable period. As a result, if one rogue banker within a Swiss bank has engaged in conduct amounting to offenses under the aforementioned U.S. tax and monetary laws, the bank may fail to qualify under Category 3 even if its executive management had no reason to believe that such offenses may have been committed. Assuming this is intended to be an absolute standard, then it is improbable that any eligible Swiss bank would qualify under Category 3. Similar to the Category 4 de minimis test, in principle a similar flexible and equitable standard should be adopted for Category 3 purposes in making this ''committed any offenses'' determination.

It appears that the U.S. authorities carefully considered the timing implications to a bank in choosing whether to participate as a Category 3 bank. This is because the expression of intent to participate in the program as a Category 3 bank must be made no earlier than July 1, 2014. Because the deadline for filing a letter expressing intent to request a non-prosecution agreement (NPA) as a Category 2 bank must be submitted by December 31, 2013 (discussed further below), a Swiss bank that chooses to participate as a Category 3 bank must initially forgo the opportunity to elect into the program as a Category 2 bank. This forces banks to soul search on the true level of organizational culpability before trying to slide under the radar as a Category 3 bank.

Apparently recognizing that a Swiss bank may initially in good faith incorrectly conclude that it satisfies the criteria for Category 3, the program states that the Tax Division may consider whether to enter into discussions with the Swiss bank under Category 2 terms if the Swiss bank requests such relief before October 31, 2014.[33] Although this possibility of falling back on Category 2 status provides some level of backstop should the Swiss bank's internal investigation reveal tax-related or monetary transactions offenses that could not have been previously discovered, it is not without risk.

First, the Tax Division could authorize an intervening formal criminal investigation against the Swiss bank following the passage of the safety period ending December 31, 2013 (that is, the program states that the Tax Division will not authorize a formal criminal investigation of any additional Swiss banks before January 1, 2014).[34] Second, the program states that relief to be treated as if a timely Category 2 request had been made ''will be granted at the sole discretion of the Tax Division, and only under extraordinary circumstances.''[35] Thus, putting aside any criminal exposure, if the Tax Division refuses to grant Category 2 treatment, the U.S. may seek penalties or fines on U.S.-related accounts that exceed the payment that otherwise would be exacted upon a timely qualifying Category 2 request.

Given that a Category 3 bank by definition has not committed any tax-related or monetary transactions offenses (that is, a ''clean'' bank vis-à-vis the U.S.), one might reasonably question why such a bank would subject itself to the burdens of going through the program. Several reasons, however, merit why a clean bill of health for the bank as approved by the U.S. government could be attractive. For starters, representatives of the bank should not have to travel in fear of being detained or questioned by U.S. authorities as has occurred in recent years.[36] Moreover, the bank can represent to the investing and financial world that it is U.S. tax compliant, thereby attracting opportunities for transactions or investments that otherwise might not

[31]*Id.* at para. III.E.2. It should be noted that the term ''independent examiner'' requires further clarification as to whether a non-U.S. attorney or accountant may serve in this capacity and also the nature and scope of the ''verification'' required under the program.

[32]*Id.* at para. III.A.3.

[33]*Id.* at para. III.C.

[34]*Id.* at para. V.A.

[35]*Id.* at para. III.C.

[36]It should be noted, however, that because the DOJ press release discussed in note 1 *supra* clearly states that individual bankers, and presumably other third-party advisers, are not included within the scope of protection set forth in the program, bankers and advisers must process their own individual cases. It is theoretically possible, and in appropriate circumstances probable, that an errant banker associated with a forgiven bank could face U.S. legal issues when traveling to the U.S. even after the Swiss bank has been issued a non-target letter.

materialize. And as mentioned above, the financial world continues to move toward a model of transparency where many countries around the globe are adopting FATCA-type rules, and the ability to embark in this new global environment with a clean slate from the U.S. should facilitate a smooth transition.

Category 2 Bank

Although the least desirable of the participating categories under the program (excluding, of course, Category 1 banks already under criminal investigation), the Category 2 bank is given the opportunity to obtain an NPA (or alternatively a deferred prosecution agreement (DPA)) from the U.S. in exchange for complying with numerous preconditions, and upon payment of a potentially significant penalty.

A Category 2 bank is a Swiss bank that has reason to believe it may have committed tax-related offenses under titles 18 or 26, or monetary transactions offenses under sections 5314 or 5322 of title 31, in connection with undeclared U.S.-related accounts held by the Swiss bank during the applicable period.[37] A bank choosing to participate in the program as a Category 2 bank must provide a letter to the Tax Division expressing its intent no later than December 31, 2013.[38]

Several aspects of the program for a Category 2 bank will require extensive and careful analysis. However, the initial determination by a bank about whether it has reason to believe such offenses have been committed is crucial. The program does not provide a set criteria or standard regarding the nature or quantum of evidence that might give a bank reason to believe. In many cases, clear evidence of wrongdoing on the part of one or more individuals within the organization may be apparent or possibly institutional-wide systemic wrongdoing. In other cases, it might be a close call.

A potentially significant premium emerges under the program to properly analyze and make this legal determination because of the timing considerations for participating in the program. As noted, a Category 2 bank must express its intentions to the Tax Division by December 31, 2013, whereas a Category 3 bank may express its intentions no earlier than July 1, 2014. Thus, a huge sense of urgency exists to ascertain whether the bank has reason to believe it has committed tax-related or monetary transactions offenses. If the bank holds out to potentially submit as a Category 3 bank but does not appropriately qualify as such, it runs risks as laid out above.

[37]The program, para. II.A.

[38]*Id.* at para. II.B. As discussed above, this December 31, 2013, deadline is trumped by an even earlier deadline mandated under Swiss law by FINMA requiring all licensed Swiss banks to provide notice by December 9, 2013, to FINMA regarding each bank's category determination under the program. FINMA Newsletter 50, at 3. *See also* http://www.sif.admin.ch/themen/00502/00806/index.html?lang=en.

Because of this timing constraint, there may be an inclination on the part of Swiss banks to opt into the Category 2 status by year-end with a view toward backing out after more thorough internal investigation or diligence has been completed. This could be problematic, however, since the Tax Division might view the initial expression of interest as an admission of sorts, thereby locking the bank into a position that it had reason to believe that offenses had been committed. Under this scenario, it would be unlikely that the Tax Division would allow the Swiss bank to escape without payment of a monetary penalty. However, unless Category 4 is modified and clarified as discussed above, and assuming Category 3 is not clarified as also discussed above, then the program may very well force all Swiss banks to file under Category 2. Such a result would be highly unfortunate and would effectively convert what could have been a flexible, equitable, and practical program into the opposite.

Another significant consideration for any participating Category 2 bank is the penalty payment required upon execution of an NPA. The Swiss bank must agree to pay as a penalty an amount calculated on a sliding scale that ranges from 20 to 50 percent of the maximum aggregate value of U.S.-related accounts that existed or were opened at various times from August 1, 2008, through February 28, 2009 (or thereafter).[39]

A key feature of the penalty provision under the program is the allowance of a credit to the Swiss bank for U.S.-related accounts that were:

- not undeclared;
- disclosed by the Swiss bank to the IRS; or
- disclosed to the IRS through an announced offshore voluntary disclosure program or initiative following notification by the Swiss bank of such a program or initiative and before the execution of the NPA.

Despite the importance of this credit to reduce the Swiss bank's potential penalty, there are several open questions about how this might apply.

For instance, at what point must it be demonstrated that an account was not undeclared? Must there be evidence that the account was declared by the U.S. account holder throughout the applicable period? Alternatively, would it be sufficient to show that the account was not an undeclared account by the time the final NPA or DPA is executed?

Also, the language contained in the program requires that in order to obtain corresponding penalty reduction, disclosure of an account to the IRS through one of the voluntary disclosure programs occurs ''following notification by the Swiss bank'' of the program

[39]The program, para. II.H.

and before execution of the NPA.[40] But what if a U.S. noncompliant customer independently learns about the voluntary program, say in 2009, goes through the voluntary disclosure program and becomes compliant, and at the time of signing the NPA was thus not undeclared and the Swiss bank never made any notification? It would seem reasonable that a Swiss bank should be entitled to a penalty reduction for any account that was declared before execution of the NPA (otherwise both the bank and the account holder are subject to penalty on the same account).

There also needs to be clarification on how a bank could show that a customer became U.S. tax compliant, particularly if the bank was unaware of the customer's participation in the voluntary disclosure program or if the customer was U.S. tax compliant. There are likely numerous situations where banks may have encouraged account holders to enter voluntary disclosure, but have no knowledge concerning whether the account holders in fact participated in an offshore voluntary disclosure program or initiative.

Finally, query whether the Streamlined Filing Compliance Program for Non-Resident, Non-Filer U.S. Taxpayers is considered an ''initiative'' for which a Category 2 bank will receive credit? Given the large number of U.S. citizens and green card holders living abroad and properly complying with all tax obligations in their country of residence, this could be a relevant factor in reducing the Swiss bank's penalty exposure.

As another substantial precondition to any NPA granted for a Category 2 bank, the Swiss bank must provide all necessary information for the U.S. by reason of treaty requests to seek account information. As noted in the joint statement, Switzerland intends to process on an expedited basis treaty requests according to the existing treaty as well as the 2009 protocol, if and when it comes into force.[41] Thus, the cooperation of Category 2 banks with the Tax Division will provide an even greater amount of information that can be used to identify and prosecute U.S. taxpayers who violate U.S. laws by concealing assets abroad. Primary targets of this valuable information, as emphasized by the DOJ in its August 29, 2013, press release, are ''U.S. taxpayers who, when faced with the risk of detection, chose to move funds away from banks under investigation to banks that they believed might be better havens for tax secrecy.'' The press release notes that ''[a] key component of the Program requires cooperating banks to provide information that will enable the U.S. to follow the money to other Swiss banks and to banks located in other countries.''

One final word of caution. For those Swiss banks that have grounds to apply as a Category 2 bank under the program, rumors have been circulating that a ''better deal'' can be generated by simply pushing the bank into (or allowing it to fall into) Category 1 on the theory that the penalty profile of a Category 1 resolution would be more favorable than a penalty resolution under Category 2. Arguments have been circulating that the percentage of penalties given in the Liechtenstein Landesbank settlement as well as the Wegelin settlement serve as a benchmark for the preferential treatment. However, these comments seem to be far-fetched for many reasons. First, it is unlikely that those in Category 1 will be more favorably treated in an economic or penalty sense compared with those in Category 2. Secondly, attempting to initiate an overt criminal investigation with the DOJ is tantamount to putting one's head into the mouth of the alligator — expecting a better-natured experience but not suffering decapitation. DOJ criminal investigations involving Switzerland implicate huge elements of criminal risk, including jeopardizing the bank as a going concern and years of distraction including huge legal and other support fees, to mention just some of the reasons why Category 1 should be the last resort of any bank.

Conclusion

On balance, the program appears to present a potentially practical resolution to the prolonged battle waged by the U.S. tax authorities over Swiss bank secrecy. The proof, however, will be seen in the U.S. government's administrative handling of the Swiss banks' requests to participate in the program. For this program to be a success, the Swiss banks should have a reasonable expectation for an efficient and fair handling of their cases by the DOJ with IRS support. Regardless of whether a Swiss bank seeks to participate as a Category 2, Category 3, or Category 4 bank, virtually all Swiss banks will need to quickly and accurately collect and analyze the relevant data for the respective categories, taking both U.S. and Swiss legal issues into consideration. ◆

[40] *Id.* As discussed in note 28 *supra*, the assistant attorney general addressed issues pertaining to the program, including the penalty issue. These comments indicate that the DOJ intends to apply a restrictive interpretation of this penalty credit.

[41] The joint statement, para. 4. *See also supra* text accompanying notes 9 and 10.