COMMENTS

SWISS BANKS AND THEIR AMERICAN CLIENTS: A FADING ROMANCE

The gold drain, the international finances of organized crime, the continuing vulnerability of securities markets to manipulation and misrepresentation, and the feeling of the "little man" that he shoulders a disproportionate share of the tax burden have all directed hostile public attention to those nations which recognize banking secrecy. There are a number of such jurisdictions;[1] but four centuries of uninterrupted political and economic stability, the solidarity of the franc and a deep-rooted commitment to financial privacy have made Swiss banks the traditional favorite of Americans seeking the protection of secret accounts, and therefore the most heavily criticized in the United States. The Swiss Supreme Court recently made a significant departure from established Swiss policy on disclosure of banking secrets, and the United States has enacted major legislation to impede the use of secret accounts to escape its domestic laws. It is the purpose of this comment to examine these developments and evaluate their impact on Americans who bank in Switzerland.

I. THE PROBLEMS

The Swiss bank account has long been a basic financial planning tool in the hands of moneyed citizens of underdeveloped nations who face chronic inflation, oppressive taxation, and confiscation by revolutionary regimes. Legend places the untold wealth of American millionaires and racketeers in the vaults of Switzerland. Since the advent of relatively low cost jet travel many Americans of more moderate means have discovered that the secret bank account is not a luxury available only to the rich.[2]

1. The Bahamas, Curacao, Hong Kong, Liechtenstein, Luxembourg, Panama and West Germany all have bank secrecy laws which have been employed by Americans in various schemes. Note, *Secret Foreign Bank Accounts,* 6 TEXAS I. L.F. 105 (1970).

2. Harry D. Schultz, London financial consultant, has estimated that 20,000 to 30,000 Americans have Swiss bank accounts with an aggregate value of between $100 and $200 million. An account may be opened by mail with a

This revelation naturally resulted from the general sophistication which the prosperity of the 1960's brought to the financial affairs of the mushrooming upper middle class. An American who wishes to accumulate and preserve wealth must jump myriad legal hurdles and bump heads with the highly professional regulatory agencies which are continually erecting them. The strength and intelligence of the adversary have improved the breed, so that the successful American "white-collar criminal" is necessarily a very resourceful individual—who would inevitably discover the advantages of banking secrecy.

A plethora of schemes to beat the system have been hatched behind the legal walls which surround every Swiss bank. Most frequently they have been conceived to evade taxes or to circumvent securities regulations, although secret accounts can be useful in accomplishing any number of illicit purposes. Among the endless possibilities are black market currency dealings,[3] kickbacks and bribes to military and government officials,[4] and gold trading.[5]

The most elementary tax evasion device is simply to deposit a suitcase full of unreported income in a Swiss bank. This alternative is available only to those who are paid by other individuals free of withholding tax, typically doctors and lawyers, and those who are in a position to skim cash receipts: archetypically gambling casino operators,[6] but more prosaically ordinary retailers.

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deposit of $100, according to Felix W. Schulthers, Chairman of the Swiss Credit Bank of Zurich, one of the "big three" Swiss banks. Wall Street Journal, June 10, 1971, at 1, col. 4. A "conservative" estimate of total American holdings in secret foreign accounts "could easily run into the hundreds of millions of dollars." *Trying to Unveil Secret Bank Accounts*, BUS. WEEK, Feb. 28, 1970, at 98. Naturally, any accounting is more or less guesswork.

3. *See* Statement of Lane Dwinell, Assistant Administrator for Administration, Agency For International Development; accompanied by Daniel Cohen, Special Assistant to Chief, Financial Review Division; Leslie A. Grant, Deputy General Counsel, and Robert R. Parker, Former Attache and Chairman of the Irregular Practices Committee, American Embassy, Saigon, Vietnam, *Hearings on H.R. 15073 Before the House Committee on Banking and Currency*, 91st Cong., 1st Sess., at 122-28 (1969) [hereinafter cited as *Hearings on H.R. 15073*].

4. *See* Statement of Frank A. Bartino, Assistant General Counsel, Manpower and Reserve Affairs for the Department of Defense, *id.* at 128-135, and Wall Street Journal, Feb. 26, 1970, at 13, col. 1.

5. *E.g.*, the Justice Department has charged Bernard Cornfeld and his Geneva-based mutual fund complex, I.O.S. Ltd., with buying and selling $37.5 million in gold for speculation during the 1968 gold crisis, reaping a profit of nearly $9 million. Wall Sreet Journal, Dec. 3, 1971, at 4, col. 2.

6. *See* Wall Street Journal, July 14, 1966, at 1, col. 7.

Since Swiss banks provide the investment services of their American counterparts, as well as those provided by brokerage houses, the Swiss bank depositor's unreported income is working for him rather than being eaten by inflation in a wall safe or safety deposit box.

The benefits of a Swiss account have not been available exclusively to cash operators who can avoid reporting income. Anyone who deals overseas can divert money into a Swiss bank via the double invoice system.[7] An American seller can instruct his foreign buyer to deposit a portion of the sale price into the seller's Swiss account and remit the remainder to the seller in the United States, which will be recorded as the gross receipts from the transaction. The American seller provides the foreign buyer with an invoice for the full price. Similarly, an American buyer of imported goods instructs his seller to issue an invoice in an amount greater than the purchase price. He then transmits this sum to the seller who retains the actual sale price, and deposits the balance in the American buyer's Swiss account.

Americans who have already paid taxes have experienced little difficulty depositing money in Swiss accounts without the Internal Revenue Service discovering its new location. Limited amounts can be carried to a point conveniently outside the country and from there transmitted to a Swiss bank.[8] In the case of more substantial sums, U.S. citizens have formed Lichtenstein trusts to which they "loan" money.[9] The trust would then open

7. A slightly more complicated, but safer, device employed by American sellers involves payment of "commissions" to an alter ego Liechtenstein trust. *See* Statement of Robert Morganthau, [former] U.S. Attorney, Southern District of New York, *Hearings on the Legal and Economic Impact of Foreign Banking Procedures on the United States Before the House Committee on Banking and Currency*, 90th Cong., 2d Sess., at 14 (1968) [hereinafter cited as *1968 Hearings*], and Statement of Pierre Laval, Former Chief Attorney, Appellate Division, Southern District of New York, *Hearings on H.R. 15073, supra* note 3, at 11.

8. Swiss banks have been known to send courriers to pick up the deposits of their American clients, as well as representatives to solicit new business in the United States. *See* Wall Street Journal, Nov. 27, 1968 at 1, col. 1 and Wall Street Journal, *supra* note 4.

9. Business trusts may be established anonymously under Liechtenstein law. A local lawyer will set up the legal entity for a modest fee, listing himself as founder in the Commercial Register. The name of the owner never appears anywhere. The entity need not have a business office in Liechtenstein; an "authorized representative" is all the presence that is required. *Hearings on H.R. 15073, supra* note 3, at 366-67, has a brief explanation. The tiny principality shares a common boundary with Switzerland, making for close cooperation between Liechtenstein lawyers and Swiss bankers. One Liechtenstein lawyer is reputed to be the president of some 400 corporations. *Id.* at 45.

a Swiss account, deposit the cash and default on the "loan." Not only has the "lender" gotten his money out of the country on a pretense which can not be proven fraudulent, but he has also acquired a bad debt deduction against future reported income.[10]

American investors have employed Swiss accounts to mask violations of U.S. securities regulations with notable success.[11] Effective policing of securities markets by the Securities Exchange Commission depends on the ability to recreate market activity.[12] Enforcement of the regulations is a relatively manageable task when all records pertinent to a transaction, such as margin agreements and the identities of real parties in interest, are available to the SEC. But it becomes impossible when the "paper trail" ends at the door of a Swiss bank.

The most problematic area for the SEC has been the use of Swiss banking secrecy to circumvent margin requirements.[13] Violent price fluctuation can result when market activity in a stock is being financed by large amounts of unregulated credit.[14] Foreign lenders are not subject to the margin requirements,[15] so

10. *Id.* at 26.

11. Americans suspected of using Swiss accounts for various illegal activities generally have fared well, judging from the reults of an intensive 1969 investigation in the Southern District of New York. For each case prosecuted there were six where the U.S. Attorney had specific information that a crime had been committed but could not prosecute, and "thousands" of others not even touched by the investigation. *Id.* at 91.

12. *See* Statement of Robert M. Morganthau, U.S. Attorney for the Southern District of New York, *Hearings on H.R. 15073, supra* note 3, at 20-24, and Statement of Irving M. Pollack, Director, Division of Trading and Markets, Securities and Exchange Commission, *id.* at 175-311, for a comprehensive survey, including examples and figures, of the variety of stock market intrigues which have been shielded by Swiss bank secrecy.

13. Current margin requirements are found in 12 C.F.R. § 207.5 (1970) established pursuant to the Securities Exchange Act of 1934 § 7, 48 Stat. 886, *as amended* 15 U.S.C. 78g (1970).

14. Securities are commonly purchased "on margin;" that is, on credit collateralized by the securities themselves. When the market value of the securities falls below a certain level, the lender has insufficient collateral and will make a "margin call." The borrower must then put up additional collateral or be "sold out" by the lender. Selling, of course, depresses the market and margin calls go out to other borrowers, in turn pushing the market farther down as they are sold out, and so on. This is called a "spiral effect." When credit is tightly regulated, the same amount of credit extended will purchase fewer shares, so fewer are sold to liquidate loans in a market decline, and spiraling is minimized. But the greater the proportion of credit which may be extended to the value of the securities purchased, the more the shares which may be purchased on the same amount of credit, and the more which will be dumped as the market starts to recede. Hence, the spiral is accelerated.

15. The courts have consistently denied extraterritorial application of the

American investors have frequently traded on insufficiently collateralized purpose credit obtained from Swiss banks.[16] Such violations have gone largely undetected because Swiss banking secrecy prevents SEC discovery of the identity of the investor and the terms of his credit arrangement.[17]

The margin requirements are applicable to the conglomerate financing a tender offer as well as to the in-and-out trader.[18] The position of minority stock holders is clearly jeopardized when an overextended acquiring company defaults and controlling interest falls into the hands of a Swiss bank, possibly acting as agent for unknown principals.[19]

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margin regulations; *e.g.*, Metro-Goldwyn-Mayer v. Transamerica Corp., 303 F. Supp. 1354 (S.D.N.Y. 1969), Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969).

16. *E.g.*, 1969 Arzi Bank AG of Zurich plead guilty to charges of allowing its American clients to trade over $20 million in securities on as little as 10% margin. *See* Statement of Robert Morganthau, U.S. Attorney for the Southern District of New York, *Hearings on H.R. 15073, supra* note 3, at 23, and Wall Street Journal, Dec. 2, 1968, at 10, col. 3.

17. Sophisticated stock market cabals are rarely exposed without the help of cooperative insiders, as in the Gulf Coast Leaseholds case, *1968 Hearings, supra* note 7, at 12-13. American promoters acting through four Liechtenstein trusts acquired 750,000 shares of worthless unregistered stock. The stock was sold through American brokerage houses at prices manipulated to over $16 a share. Once the profits were tucked away in Swiss accounts, the stock rapidly fell to under a dollar. One of the American promoters managed to parlay an original investment of $20.80 into profits of over $4 million. United States v. Kelly, 349 F.2d 720 (2d Cir. 1965), *cert. denied*, 384 U.S. 947 (1966).

18. A stock secured loan made for the business purpose of purchasing a controlling interest in a corporation is subject to Federal Reserve Board Regulation U (which applies to United States banking institutions). 12 C.F.R. § 221.110(b)(2) (1969). Eurodollar financing of tender offers became popular during the conglomerate epidemic of the late 1960's. The advantage of foreign financing was illustrated when Kirk Kirkorian, through his privately held Tracy Investment Company, took over Metro-Goldwyn-Mayer (MGM). When the financing arranged in the United States was blocked on antitrust grounds, Tracy arranged to borrow $62 million from two European banks. Both loans required a pledge of securities having a value of not less than 150% of the value of the loan as collateral. A United States lender would have had to require a pledge of securities having a value of not less than 500% of the loan under the domestic requirement of 80% margin then in effect. *See generally* Statement of Irving M. Pollack, Director, Division of Trading and Markets, Securities and Exchange Commission, *Hearings on H.R. 15073, supra* note 3, at 176-77, 297-98.

19. In 1969 Liquidonics Industries purchased controlling interest in UMC Industries with a loan of $40 million from the Banque de Paris at des Pays-Bas (Suisse). Liquidonics went into arrears and was forced to sell its interest in UMC to Overseas International Corp., S.A., a Luxembourg subsidiary of Banque de Paris. It was clear that control of UMC had shifted to Banque de Paris, but it was not clear whether Banqe de Paris had purchased the stock

Corporate insiders, trading on the basis of inside information and not filing insider forms, have obscured their identities through Swiss banks, making it impossible to link trader with trade.[20] The insider's advantage could be enhanced by trading on excessive margin to maximize leverage; the profits from such in-and-out trading could of course be taken free of U.S. short-term capital gains treatment.

Several clever techniques have been developed to repatriate the untaxed wealth held by market speculators and other taxpayers in Swiss accounts. An account holder could "borrow" his own money from his Swiss bank, a service regularly performed by Swiss banks for a nominal fee.[21] The taxpayer got the use of his money and avoided a tax prosecution on a "net worth" theory, plus he could deduct the interest that he was paying himself on the "loan." Or he could "sell" assets to himself through his Swiss bank.[22] He would keep the property, the income accumulating in his account, and his repatriated money would be taxed at the long term capital gains rate. An extra layer of insulation could be provided by forming a Lichtenstein trust to "buy" the property.

II. THE SWISS LAW

Swiss banking secrecy manifests the traditional Swiss belief in the unfettered right of personal privacy, particularly with regard to financial affairs. Its existence in private law dates back to the advent of organized banking in the sixteenth century.[23] The banker's pledge of secrecy was first recognized in customary law and then later as part of the mandatory's duty of loyalty as well as the individual's right of privacy.[24] Tort liability to the "master of the secret" subsequently attached to a banker's viola-

as principal or as an agent for undisclosed interests. *Hearings on H.R. 15073, supra* note 3, at 176-77, 293-96.

20. *E.g., 1968 Hearings, supra* note 7, at 55-61 and *Hearings on H.R. 15073, supra* note 3, at 12-13, 21-22.

21. This is called a "plugged" or "window dressing" loan; it is a standard technique in organized crime for legitimizing illegally obtained funds. Statement of Fred M. Vinson, Jr., Assistant Attorney General, Criminal Division, Department of Justice, *1968 Hearings, supra* note 7, at 7-10. An ingenious derivation is the "three cornered window dressing loan," used to "beef up" the anemic balance sheet of an American borrower. *Id.* at 52, for a brief explanation of the details.

22. *Id.* at 49.

23. Mueller, *The Swiss Banking Secret,* 18 INT'L & COMP. L.Q. 360, 361 (1969).

24. *Id.*

tion of the right to privacy in financial affairs, and a client can also recover damages under a contract of agency theory.[25] Swiss courts have traditionally held that confidentiality is an implied contractual obligation not dependent on an express agreement.[26]

It was not until the 1930's that banking secrecy was established in public law. Nazi Germany was attempting to gain access to assets which had been placed in Swiss banks by German Jews and other enemies of the Reich.[27] To guarantee protection of depositors against such threats, the Swiss Parliament codified the banker's duty in article 47(b) of the Banking Law of 1934:[28]

> Anyone who in his capacity as an officer or employee of a bank, or as an auditor or his employee, or as a member of the banking commission or as an officer or employee of its bureau intentionally violates his duty to observe silence or his professional rule of secrecy or anyone who induces or attempts to induce a person to commit any such offence, shall be liable to a fine of up to 20,000 francs or imprisonment for up to six months, or both.
>
> If the offender acted with negligence he shall be liable to a fine up to 10,000 francs.

In addition to the criminal liability imposed by article 47(b) of the Banking Law, a bank may be sued for damages for breach of secrecy under article 97 of the Law of Obligations.[29]

The obligation of banking secrecy is by no means absolute; it remains primarily a matter of private law and, as such, yields to overriding considerations of public law in certain circumstances.[30] The steadfast refusal of the Swiss government to compel disclosure of banking secrets, generally attributed by Americans to the rule of banking secrecy, are usually based as much on Swiss tax law and the distinction which Swiss law draws between criminal and administrative offenses as on article 47(b) of the Banking Law and the rule of secrecy.

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25. Note, *supra* note 1, at 117.

26. *Id.*

27. Fehrenbach, *Secrecy, Solidarity, and Style: The Swiss Banking Mystique*, BANKERS MAG., Winter 1967, at 52.

28. Mueller, *supra* note 23, at 362.

29. Note, *The "Secret" Swiss Account: End of an Era*, 38 BROOK. L. REV. 384, 387 (1971).

30. In addition to the duty to give evidence in civil and criminal judicial proceedings, discussed *infra*, exceptions to the general rule of banking secrecy may arise in cases involving heirs, family law, debt collection, bankruptcy and international money transfers. Note, *Secret Foreign Accounts*, *supra* note 1, at 119.

A bank may be required to give evidence either by the Federal Code of Civil Procedure or by one of the cantonal codes of procedure.[31] The application of cantonal law is expressly reserved by article 64(3) of the Swiss Constitution, and where a material Federal law takes precedence over cantonal procedural law, it is always specified in the Federal law.[32] The Banking Law does not contain such a provision, so the obligation of a bank to give evidence relating to the affairs of its clients is not controlled by the Banking Law, but becomes a question of cantonal and Federal Procedural law.[33] The various cantonal codes differ in their treatment of the subject, but the majority require banks to render full evidence when called upon in a civil proceeding.[34] The same is generally true in the case of criminal proceedings.[35]

A bank may be compelled to supply information to the tax authorities only with the consent of the taxpayer concerned.[36] Swiss tax law, rather than the Banking Law, achieves this result. The taxpayer's bank is in the same position as any other third party with regard to the taxpayer's dealings with the tax authorities: there is no obligation to give information.[37] This is because tax law treats the relationship between the taxpayer and the government as a confidential one,[38] consistent with the Swiss commitment to financial privacy.

The extent of Swiss international cooperation in compelling evidence is, of course, as circumscribed as the Federation's pow-

31. Mueller, *supra* note 23, at 366.

32. *Id.* at 366-67.

33. *Id.* at 367.

34. *Id.* at 367.

35. Note, *Swiss Banks and the Avoidance of American Tax and Securities Laws: An Assessment Based on Proposed Legislation*, 3 N.Y.U.J. INT'L L. & POL. 94, 96 (1970).

36. Mueller, *supra* note 23, at 371.

37. *Id.*

38. Swiss tax authorities nevertheless are able to extract revenues by virtue of the device of "Ermessenstaxation" or "taxation d'office". Meyer, *The Banking Secret and Economic Espionage in Switzerland*, 23 GEO. WASH. L. REV. 287, 295 (1955). This is an assumption of income or wealth which the taxpayer can rebut only by producing evidence of his debts and expenses, such as bank statements. A taxpayer who does not supply true information to verify his tax liabilities risks being taxed on this basis. The high withholding of 30% on capital income and interest on bank deposits serves to prevent large-scale evasion. Also, the tax authorities have access to information from the returns of other taxpayers, so there is really no practical need for evidence from third parties. Mueller, *supra* note 23, at 371.

er to compel evidence in its own interest. Like most nations, Switzerland extends assistance in civil and criminal matters but not in matters of administrative law.[39] Switzerland will not, however, assist in the prosecution of military, political or fiscal crimes, or in any other case where a domestic prosecution would violate the "*ordre public.*"[40] Tax evasion, securities, and foreign exchange violations are considered fiscal or administrative offenses, therefore the Swiss refuse legal assistance in these areas. In the case of information subject to bank secrecy, requests for judicial cooperation will be subject to the rules of cantonal procedure.[41] The Swiss Federal Court will not compel a bank to disclose information which it could not be required to disclose, given similar facts, under the cantonal code of civil procedure of the particular canton.[42]

Banking information unavailable to the Swiss tax authorities is similarly unavailable to foreign tax authorities. Generally, a disclosure of any information concerning a taxpayer will only be allowed where provided for by a double taxation convention.[43] Information supplied to the U.S. Internal Revenue Service has mainly concerned apportionment of profits to business operations permanently established in one or the other country and the allowance of credit by one country for withholding taxes already paid in the other.[44]

The Swiss Federal Tax Administration has heretofore consistently denied requests of the U.S. Internal Revenue Service for information on assets deposited in Swiss banks or on the banking activities of U.S. clients.[45] The logic has been that third persons, including banks, are not required to give information to tax authorities in Switzerland and further, such a disclosure would be violative of the bank's duty of secrecy.[46] Both objections have relied on exceptions to the general obligation to exchange information specifically provided in the Convention with the Swiss Confederation for the Avoidance of Double Taxation With Respect to Taxes on Income.[47]

39. Mueller, *supra* note 23, at 374.
40. *Id.* at 375.
41. *Id.* at 374.
42. *Id.*
43. *Id.*
44. *Id.* at 375.
45. *Id.*
46. *Id.* at 376.
47. Convention with the Swiss Confederation for the Avoidance of Double

III. X v. THE FEDERAL TAX ADMINISTRATION

In 1970, the Swiss Federal Supreme Court took a fresh look at internal Swiss law and the Double Taxation Convention of May 24, 1951.[48] A cynic might argue that *X v. The Federal Tax Administration* was decided to placate the United States, which was viewing with increasing disapproval the aplomb with which Americans were using Swiss banks to neutralize United States laws.[49] Regardless of the Court's motives, its decision was an unprecedented departure from the traditional Swiss position on banking secrecy.

Article XVI, paragraph 1 of the Convention[50] provides for the exchange of information necessary for the "prevention of fraud or the like," in the areas of taxation subject to the convention.[51] Pursuant to this provision the United States Internal Revenue Service requested from the Federal Tax Administration (FTA), its Swiss counterpart, information from bank records regarding the activities of an American citizen suspected of tax fraud. The FTA conducted an investigation of its own and determined that the suspicion of the IRS was well-founded. The results of the investigation were summarized in an order and the FTA notified X and his bank that it would transmit its findings to the IRS.

X appealed the FTA order, ultimately bringing the dispute before the Court. Two significant issues were raised: first, under what circumstances is the FTA required to furnish any information to the IRS; second, does the FTA's obligation extend to information protected by bank secrecy. Resolution of these ques-

Taxation With Respect to Taxes on Income, May 24, 1951, [1951] 2 U.S.T. 1751, T.I.A.S. No. 2316 [hereinafter cited as Convention].

48. X v. The Federal Tax Administration, 10 INT'L LEGAL MATERIALS 1029 (Swiss Federal Supreme Court, Dec. 23, 1970) (1971) (unofficial U.S. Department of Justice translation), U.S. Tax Cas. (71-2, at 86566) ¶ 9435 (unofficial CCH translation).

49. P.L. 91-508, discussed at length *infra*, had been enacted less than two months before X v. The Federal Taxation Administration came down. The stock market had been in a year long slump and several prominent brokerage firms had folded. American politicians, with support from the press, were decrying unregulated credit, insider trading, market manipulations, and other abuses which had proliferated during the speculative euphoria of the bull market.

50. Convention, *supra* note 47.

51. The United States Federal income taxes, including surtaxes and excess profits taxes, and Swiss federal, cantonal and communal taxes on income. *Id.* art. I, § 1.

tions gave the Court an opportunity to interpret the Convention.

Article XVI, paragraph 1 sets forth the obligation mutually undertaken:

> The competent authorities of the Contracting States shall exchange such information (being information available under the respective taxation laws of the contracting parties) as is necessary for carrying out the provisions of the present Convention or for the prevention of fraud or the like in relation to the taxes which are subject to the present Convention. . . .[52]

This obligation is subject to the limitations found in article XVI, paragraph 3:[53]

> In no case shall the provisions of this Article be construed so as to impose upon either of the contracting States the obligation to carry out administrative measures at variance with the regulations and practice of either contracting State or which would be contrary to its sovereignty, security or public policy or to supply particulars which are not procurable under its own legislation or that of the State making application.

Noting that a distinction between prevention and suppression of fraud would be a fatuous one in the realm of fiscal regulation, the Court determined that "prevention of fraud and the like" must be read in a broad sense to mean prevention of the ultimate success of fraudulent acts.[54] The obligation of the FTA to furnish information exists, then, when tax fraud has already been committed and, strictly speaking, can no longer be prevented. Nor is the obligation of the FTA conditioned on the opening of tax fraud proceedings in the United States. The Court felt that the determination of whether or not information is necessary to prevent fraud should not turn on such a formal criterion. All that is really necessary is a "factually well-founded suspicion" that tax fraud or the like has been committed or is being planned.[55]

What constitutes "fraud or the like" must be interpreted according to Swiss tax law.[56] Swiss law employs varying terminology and is not uniform in definition of the elements of a tax offense, but the Court felt that it was safe to say that the use of

52. Convention, *supra* note 47.

53. *Id.*

54. X v. The Federal Taxation Administration, 10 INT'L LEGAL MATERIALS at 1031 (1971).

55. *Id.*

56. Convention, *supra* note 47, art. II, ¶ 2.

"fraudulent means," particularly false or falsified or substantially untrue documents, is generally considered a "serious offense."[57] This is true whether the deception is an aggravated form of tax evasion or a separate offense subject to sanctions beyond penalty taxes.[58] Swiss doctrine universally considers deliberate deception of tax authorities by the use of substantially untrue documents for the purpose of obtaining an illegal tax advantage to be tax-fraud. "Fraud and the like" therefore can be understood to include "at least these offenses."[59]

Having made reasonably clear the circumstances under which there is a general obligation to furnish information to the IRS, the Court attacked the problem of whether banking information can be furnished without running afoul of banking secrecy. Article XVI can be understood to mean that the FTA will make available any information which it could secure from a Swiss bank if the facts were analogously transposed.[60] The decisive consideration then is whether Swiss law compels a bank to disclose information sought by the FTA to shed light on suspected fraudulent acts of the bank's client. Federal law is silent on the question, but a variety of answers may be found in the cantonal tax laws.[61]

This led the Court to the question of whether the Federation had undertaken a federal obligation to furnish banking information in certain cases, or had merely obligated itself to exchange that information which could be procured under applicable cantonal law on analogous facts. The Federation may conclude treaties and international agreements on matters within the competence of the cantons, in which case any contrary cantonal law is automatically superseded.[62] If a federal obligation had been established by article XVI, then such an obligation would take precedence over any divergent cantonal law, notwithstanding cantonal tax sovereignty provided by the Federal Constitution.[63]

The Court could find no clues in either the text of the Convention or the notes and materials as to whether a federal obliga-

57. X v. The Federal Tax Administration, 10 INT'L LEGAL MATERIALS at 1031 (1971).
58. *Id.* at 1031-32.
59. *Id.* at 1032.
60. *Id.* at 1034.
61. *Id.*
62. The Court cites article 8 of the Federal Constitution. *Id.*
63. *Id.* at 1035.

tion had, in fact, been intended by the parties. This dilemma, which, curiously, had not become apparent until 20 years after the conclusion of the treaty, conveniently turned out to be almost self-resolving. If the Swiss commitment was only to furnish bank information obtainable under applicable cantonal law, then the same information would be available or not available to the IRS, depending on the location of the suspected American's bank. In choosing their Swiss banks devious American taxpayers would make the obvious geographical selection. Clearly the United States had not bargained for a pledge of such limited value.

The Court reasoned that the United States naturally must have been mainly interested in the availability of banking information from Zurich, Basel and Geneva, the three internationally important banking centers where the question would be most likely to arise. In the cantons of Zurich, Basel-Stadt and Geneva, tax fraud is a criminal offense and prosecutions are governed by the respective cantonal codes of criminal procedure.[64] Banks in these cantons must give full evidence in criminal prosecutions.[65] While this is a rule of criminal procedure, its ultimate basis is in cantonal tax legislation which defines tax fraud as a criminal offense, and thereby renders it subject to the law of criminal procedure.[66] This is to say that banking information is compelled not only for reasons of the law of criminal procedure but also, in the case of tax fraud, for reasons of tax law.[67]

The United States might readily have understood the law in the major banking cantons to be the prevailing Swiss concept and that banking information was, in fact, "information available under the . . . taxation laws . . ." of Switzerland.[68] The Court could not reject the forceful insight of this analysis and concluded that the obligation to furnish information in support of tax fraud investigations includes banking information, despite any contrary position expressed in the tax legislation of less internationally important cantons.[69]

The significance of *X v. The Federal Tax Administration* to Americans fraudulently evading taxes through Swiss accounts is

64. *Id.* at 1036.
65. *Id.*
66. *Id.*
67. *Id.*
68. Convention, *supra* note 47, article XVI, ¶ 1.
69. X v. The Federal Tax Administration, 10 INT'L LEGAL MATERIALS at 1036 (1971).

evident. But, when applied in concert with a recent United States development, its impact may be fatal to Americans utilizing Swiss bank secrecy for other schemes as well. The Federal Income Tax Form 1040 now asks the taxpayer "[d]id you, at any time during the taxable year, have any interest in or signature on other authority over a bank, securities, or other financial account in a foreign country. . . .?" If the taxpayer checks the "yes" box, he is instructed to attach an additional form setting forth the specifics.[70]

A United States taxpayer maintaining a Swiss account as a vehicle for any illicit purpose will necessarily deny the fact. But if he does so he commits an act of tax fraud under federal law,[71] and one which conforms to the definition of tax fraud formulated in *X v. The Federal Tax Administration.* Use of a Swiss account in a matter which Swiss law would treat as a fiscal or administrative, rather than a criminal, offense, and for which assistance in a United States prosecution would be refused, now necessitates an act of tax fraud of the sort for which Switzerland has indicated it is willing to roll back the cover of banking secrecy. The Internal Revenue Service, if it can demonstrate a "factually well-founded suspicion" of tax fraud, would now seem to be in a position to obtain evidence usable in a subsequent prosecution on other charges and for which the Swiss would not make bank information available.

Whether the Court was contemplating such an eventuality when it decided *X v. The Federal Tax Administration* is pure speculation, but there is nothing in the language of the opinion which forecloses the possibility. Perhaps the inclination of the Court to dilute, via the Convention, the protective opacity which Swiss law has traditionally afforded Americans can be estimated by a comparison with its decision in *Johann Senn, Bank fuer Handel und Effekten v. United States, Office of the Zurich Dis-*

70. Federal Income Tax Form 4683.

71. INT. REV. CODE of 1954, § 7206(1) makes it a felony to: "Willfully [make] and [subscribe] any return, statement or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter. . . ." Note that this section creates criminal tax fraud liability for falsifying a return regardless of the tax consequences of the falsehood; it need only be shown that the taxpayer signed a document he knew to be false. *See* R. SCHMIDT, LEGAL AND ACCOUNTING HANDBOOK OF FEDERAL TAX FRAUD 6 (1963).

trict Attorney and Office of the Public Prosecutor of the Canton of Zurich.[72]

In *Johann Senn* a United States citizen, Rosenbaum, and a Swiss bank executive, Senn, were suspected of defrauding the United States government of several million dollars on a Navy rocket launcher contract using the "over-invoice" technique. Among its costs the American contractor, controlled by Rosenbaum, listed billings from European subcontractors, which were in actuality Lichtenstein trusts set up by Rosenbaum, and were not really supplying any parts at all. The contractor dutifully paid the bogus bills presented by the fictitious suppliers and the receipts were placed in Rosenbaum's account at Senn's bank.

The United States Department of Justice informed the Zurich District Attorney, in whose jurisdiction Rosenbaum was known to have an account, of its suspicions. An investigation by the District Attorney resulted in a Swiss prosecution.[73] The Department of Justice then applied for access to various bank records as an injured party in a criminal prosecution.[74] The records were supplied, but the Swiss investigating judge required an affadavit that they would not be used by the United States for "fiscal purposes."[75]

The bank information in *X v. The Federal Tax Administration* was requested and furnished under a different legal theory, but, like the information in *Johann Senn*, it was for use in a criminal prosecution.[76] In allowing the breach of banking secrecy in *X v. The Federal Tax Administration*, the Court made no stipulations as to how the information could or could not be used

72. Johann Senn, Bank fuer Handel und Effekten v. United States of America, Office of the Zurich District Attorney, Office of the Public Prosecutor of the Canton of Zurich, 9 INT'L LEGAL MATERIALS 567 (1970) (Swiss Federal Court, Session of Oct. 1, 1969) (unofficial U.S. Department of Justice translation).

73. The Zurich District Attorney Rosenbaum, Senn and other unidentified parties with forging of documents, being an accessory to fraud, aiding and abetting forging of documents and concealing stolen goods. *Id.* at 568.

74. Section 10(3), Zurich Code of Criminal Procedures reads:

> The injured party must be given an opportunity to inspect the files and to be present at the interrogation of the accused, so far as this can be accomplished without prejudice to the purpose of the investigation.

The bank information requested by the United States had been examined by the Zurich District Attorney and included in his investigation file. The Court saw no reason to treat a public body differently than a private person if it has been directly injured by a criminal act. Johann Senn, 9 INT'L LEGAL MATERIALS at 574 (1970).

75. Johann Senn, 9 INT'L LEGAL MATERIALS at 569 (1970).

76. *Id.*

beyond the tax fraud prosecution. In *Johann Senn* the Court did not reach the question of whether the United States would still have been granted access to the records had it not filed the formal declaration that they would not be used for fiscal purposes. It did, however, emphasize the fact that the declaration had been made in its rejection of the argument that banking secrecy had been violated,[77] strongly inferring that such a declaration is prerequisite to a disclosure of bank information for use in a foreign criminal prosecution.[78]

There is nothing in the Convention to prevent Switzerland from requiring assurances that information furnished pursuant to article XVI will be used exclusively for the purpose specified in the Article. Such a requirement would be so consistent with traditional Swiss policy that its absence is conspicuous in *X v. The Federal Tax Administration*, indicating at least a willingness to decide on a case by case basis what latitude the United States may exercise with respect to bank evidence obtained under the Convention, and at most the tacit repeal of Swiss banking and tax law for Americans.

IV. RECENT UNITED STATES LAW

By 1968 the role of banks in secrecy jurisdictions, notably Switzerland, in a variety of illegal activities ranging from income tax evasion to heroin smuggling had become obvious.[79] Negotiations with Switzerland had begun but did not appear promising. In view of the dim prospects on the international front, the House Banking and Currency Committee convened to study the problem and explore possible domestic solutions.[80] Testimony was solicited from the federal agencies and private interests concerned.[81] What emerged was Public Law 91-508,[82] containing the Foreign Accounts and Currency Transactions Reporting Act.[83] The three titles of the new legislation erect a highly detailed statutory structure, the main thrust of which is to make

77. *Id.* at 578-80.

78. *Id.*

79. The horribles are paraded in detail in *1968 Hearings, supra* note 7, and *Hearings on H.R. 15073, supra* note 2.

80. *See* generally, *1968 Hearings, supra* note 7, and *Hearings on H.R. 15073, supra* note 3.

81. *Id.*

82. Pub. L. No. 91-508 (Oct. 26, 1970), 84 Stat. 1114-1136 (codified in scattered sections of 12, 15, 31 U.S.C. (1970)).

83. 31 U.S.C. § 1051 (1970).

anonymous movement of significant sums in currency, near-money and readily liquidated securities, impossible.

Title I governs federally insured banks,[84] uninsured banks and other financial institutions,[85] requiring the maintainance of records which the Secretary of the Treasury finds are valuable in criminal, tax and regulatory investigations and proceedings.[86] Insured banks must maintain records of each account-holder and of each person who is authorized to act with respect to each account.[87] In addition, a microfilm or other reproduction of each check, draft or instrument drawn and presented for payment, or received for deposit or collection, must be made.[88] Additional records may, by regulation, be prescribed by the Secretary of the Treasury.[89] All records are to be retained for the period specified by the Secretary, which shall not exceed six years unless the Secretary determines that a longer period is necessary.[90] These requirements are subject to exemption by the Secretary.[91]

Uninsured banks and other "financial institutions" may be required to retain records of any type prescribed for insured banks.[92] "Financial institutions" include persons in the business of issuing or redeeming checks, money orders, traveler's checks or similar instruments;[93] transferring funds or credits;[94] operating a currency exchange or otherwise dealing in foreign currencies or credits;[95] operating a credit card system;[96] or performing any similar, related or substitute functions.[97] Compliance may be enforced by injunction;[98] civil[99] and criminal[100] penalties are prescribed, which are substantially increased when the infraction occurs in furtherance of a violation of another federal law.[101] For

84. 12 U.S.C. § 1829b(a)(2) (1970).
85. *Id.* § 1953(b).
86. *Id.* §§ 1829b(a)(2), 151(b).
87. *Id.* § 1829b(c).
88. *Id.* § 1829b(d)(1).
89. *Id.* § 1829b(f).
90. *Id.* § 1829b(g).
91. *Id.* § 1829b(c).
92. *Id.* § 1953(a)(1).
93. *Id.* § 1953(b)(1).
94. *Id.* § 1953(b)(2).
95. *Id.* § 1953(b)(3).
96. *Id.* § 1953(b)(4).
97. *Id.* § 1953(b)(5).
98. *Id.* § 1954.
99. *Id.* § 1955.
100. *Id.* § 1956.
101. *Id.* § 1957.

purposes of these penalties, a separate offense occurs with respect to each day on which, and each separate branch or office in which, the violation continues.[102]

Title II is the Currency and Foreign Transactions Reporting Act,[103] authorizing the Secretary to require reports from a dazzling array of businesses: banks, brokers and dealers in securities and commodities, insurance companies, pawn brokers, jewelers and travel agencies, to name a few.[104] The same civil,[105] criminal,[106] and injunctive[107] sanctions available under Title I may be imposed. Domestic financial institutions may be directed to report transactions involving the payment, receipt on transfer of United States currency or monetary instruments in such amounts or denominations and under such circumstances as the Secretary may designate.[108] Such reports may also be required of the other parties to such transactions.[109] The export or import of any monetary instruments totalling over $5,000 on any one occasion must be reported;[110] if no report is made, the instruments are subject to seizure and forfeiture to the government.[111] The Secretary may call for reports of transactions with foreign agencies in such form and disclosing such information as he finds appropriate.[112] He may also exempt or include persons, by class or individual, as well as transactions by magnitude, type or country involved.[113]

Title III amends section 7 of the Securities Exhange Act of 1934[114] to apply the various margin regulations to United States borrowers, and foreign borrowers acting on behalf of, or in conjunction with, or controlled by, United States persons, without regard to where the lenders place of business is located or where the transaction occurred. Prior to the enactment of Title III only lenders were bound to comply with the regulations and borrowers trading on nonconforming credit risked no liability.[115] The Se-

102. *Id.* § 1953(a)(2).
103. 31 U.S.C. §§ 1051-1122 (1970).
104. *Id.* § 1052(e).
105. *Id.* § 1056.
106. *Id.* § 1058.
107. *Id.* § 1057.
108. *Id.* § 1081.
109. *Id.* § 1082.
110. *Id.* § 1101.
111. *Id.* § 1102.
112. *Id.* § 1121.
113. *Id.* § 1122.
114. 15 U.S.C. § 78g(f) (1970).
115. *Id.* § 78g(c), (d).

curities Exchange Act has always limited the amount of credit which may be extended to purchase or carry securities to a certain percentage of their current market value, subject to periodic adjustment by the Board of Governors of the Federal Reserve System.[116] As investors have found new sources of purpose credit, the coverage of the margin regulations has been broadened to include more lending activities.[117] Recently American investors seeking greater leverage in the market have been borrowing extensively from foreign lenders, capitalizing on the immunity of these leaders from domestic margin restrictions, and thereby introducing large amounts of unregulated credit into American securities markets. Where the SEC was formerly powerless, it may now move to thwart undercollateralized speculative adventures, tender offers and take over attempts financed overseas.

P.L. 91-508 met strenuous objection at the hearing level. Bankers complained that making such extensive records and reports would be inordinately expensive and time-consuming, generally burdensome, and inflationary. The rapid clearing of financial transactions, essential in American economic life, would be seriously inhibited.[118] It was hoped that the regulatory power of the Secretary would be exercised to minimize the paper which P.L. 91-508 would necessitate, but when the proposed regulations to Titles I and II appeared on June 10, 1971[119] the banking industry was disappointed to find that the Secretary had not retreated from the demanding stance taken by Congress. Vigorous protest resulted in a second and somewhat relaxed set of regulations issued on April 5, 1972.[120]

All banks and financial institutions are to file reports of currency transactions greater than $10,000,[121] unless the transaction

116. *Id.* § 78g(b).

117. The lending practices of brokers and dealers are covered by FRB Regulation T, 12 C.F.R. § 220 (1970). Banks are subject to FRB Regulation U, *Id.*, § 221. FRB Regulation G was adopted to control credit supplied by nonbroker, nonbank lenders. *Id.*, § 207. To implement Title III, the Board has adopted Regulation X, Proposed Treas. Reg. §§ 224.1-224-6, 36 Fed. Reg. 19901-04 (1971).

118. *See* Statement of Clifford C. Sommer, Vice President, The American Bankers Association, *Hearings on H.R. 15073, supra* note 3, at 312-316, and Statement of Carl W. Desch, Senior Vice President, First National City Bank of New York, On Behalf of the New York Clearing House Association, *id.* at 316-322.

119. Proposed Treas. Reg. §§ 103.11-103.49, 36 Fed. Reg. 11208-11211 (1971).

120. *Id.* §§ 103.11-103.50, 37 Fed. Reg. 6912-6915 (1972).

121. *Id.* § 103.22(a), *id.* at 6913.

is solely with another financial institution or with an established customer in an amount reasonably commensurate with the ordinary conduct of the customer's business.[122] A report must be made of the customers whose transactions qualify for this exemption.[123] The identity of any person with or for whom an unexempted transaction is effected must be verified and reported.[124] Financial institutions must retain a microfilm copy of each extension of credit over $5,000 unless it is secured by an interest in real property.[125] Copies must be made of all instructions given or received regarding any transaction intended to result in the transfer of $10,000 or more in currency, securities, monetary instruments or credit to a person, account or place outside the United States.[126] Copies are required of checks, drafts, money orders and all other items, other than bank or periodic charges which debit any bank deposit account.[127] An exception is provided for dividend, payroll, insurance claim and similar checks on accounts on which 100 or more checks per month are expected to be drawn.[128] Banks must also retain copies of all items of more than $10,000 received from or remitted to any party outside the United States.[129] All copies required by the regulations must show both front and back of the item unless the back is completely blank or contains only standardized information,[130] and shall be retained for a period of five years.[131]

There is no question that P.L. 91-508 makes it very difficult to move a quantity of money unnoticed into a foreign bank account, and it is possible that its criminal sanctions will act as a further deterrent to Americans considering such a move. But whether the gathering of evidence useful in prosecuting violations of various United States laws will be facilitated, the averred purpose of the law,[132] is questionable. The bulk of the data generated is staggering; sufficiently so, that the sheer size of the "haystack" might very well make the discovery of incriminating

122. *Id.* § 103.22(b), *id.* at 6913.
123. *Id.*
124. *Id.* § 103.26, *id.* at 6913.
125. *Id.* § 103.33(a), *id.* at 6914.
126. *Id.* § 103.33(b), (c), *id.* at 6914.
127. *Id.* § 103.34(b), *id.* at 6914.
128. *Id.* § 103.34(b)(3), *id.* at 6914.
129. *Id.* § 103.34(b)(5), (7), *id.* at 6914.
130. *Id.* § 103.36(a), *id.* at 6914.
131. *Id.* § 103.36(c), *id.* at 6914.
132. 12 U.S.C. § 1951 (1970), 31 U.S.C. § 1051 (1970).

"needles" costly beyond proportion to any value they might have. Moreover, creation of elaborate bureaucratic machinery to enforce punctilious adherence to the Secretary's specifications will certainly be necessary if the law is to be effective. It is interesting to note that the responsibility for insuring compliance with the regulations is delegated to any one of eight separate federal agencies, depending on the institutional identity of the record-keeper or report-maker.[133]

The approach taken by P.L. 91-508 is that evidence of certain types of domestic transactions will eliminate the need for evidence of foreign transactions made unreachable by bank secrecy. The hitch, of course, is that an astute law breaker who can move his money without a paper trail will leave the government unable to prove any wrongdoing. For example, the currency transactions of those who regularly deal in large amounts of cash are not reported; no doubt many present or potential secret account holders either fall into this category, or else have access to such a "front." This shortcoming is largely avoided by a possible solution which has the important advantage of being far less ponderous than P.L. 91-508. Rebuttable income tax presumptions rely on the premise that money in a secret foreign account has no value to its owner unless it can be repatriated in such a manner that the IRS cannot prosecute on a net worth theory. Working on this theory, a Treasury Department spokesman has suggested a presumption to deal with taxpayers who bring their money home by "borrowing" it from their secret accounts.[134] Where a taxpayer borrows from a foreign financial institution, claiming he has furnished no collateral when a reasonable lender would have required it, and the taxpayer refuses to divulge any information, then it would be presumed that the loan was collateralized by the taxpayer's own funds. The taxpayer must then demonstrate that the money is actually borrowed or the IRS will treat it as income.

The IRS might devise other presumptions along the same line, perhaps even a blanket presumption that all receipts from foreign sources are from the taxpayer's own assets. In cases where the IRS suspects that assets are being hidden abroad by bank secrecy, it would require the taxpayer to prove the legitima-

133. Proposed Treas. Reg. § 103.46(a)(1)-(8), 37 Fed. Reg. 6915 (1972).

134. Statement of Hon. Eugene T. Rossides, Assistant Secretary of the Treasury for Enforcement and Operations, *Hearings on H.R. 15073, supra* note 3, at 62-63, 154.

cy of a foreign transaction. In all other cases the taxpayer would not be required to overcome the presumption. The use of secret accounts for illegal purposes other than tax evasion per se would also be frustrated, since all such schemes necessarily involve at least some evasion of United States taxes. Such a solution would inevitably inconvenience a few blameless taxpayers, but this is a relatively small price to be paid by only a few.

V. CONCLUSION

The ubiquitous surveillance of the financial lives of all United States citizens is unnecessary and wasteful, particularly in the light of the more cooperative Swiss attitude expressed in *X v. The Federal Tax Administration.* The cost in time and money of chronicling every detail of day-to-day banking activity imposes an unfair assessment on the American banking public, from whom it is ultimately exacted, for information of unknown enforcement value. It is by no means a remote possibility that this information has no value whatsoever. "White collar criminals" have proven themselves remarkably ingenious and not easily deterred; they should be expected to discover all the loopholes in the Act, and to develop new forms of monetary value suitable for transmission out of the United States without a trace to be found in the mountains of records and reports.

More important than the practical aspects of P.L. 91-508 are the broader policy issues it raises. Banking privacy in the United States enjoys a certain amount of constitutional protection which is seriously imperiled by the government's effort to cope with foreign banking secrecy.[135] A three-judge District Court panel has ruled that Title II of the Act is an unconstitutional invasion of the right of privacy, and has issued a preliminary injunction barring banks from making the reports which it calls for.[136] This decision underestimates the danger: the mere existence of comprehensive records detailing an individual's financial affairs invites "fishing expeditions" by regulatory agencies. That the government engages in widespread secret surveillance of its citizens, without regard for constitutional prohibitions, has been a shocking revelation to the American public. It is, however, a fact

135. *See generally* United States v. Dauphin Deposit Trust Co., 385 F.2d 129 (3d Cir. 1967), Peterson v. Idaho First National Bank, 83 Idaho 578, 367 P.2d 284 (1961).

136. Los Angeles Times, Sept. 12, 1972, at 1, col. 5.

of life, and P.L. 91-508 lends statutory legitimacy to governmental intrusion into the private lives of Americans, as well as encouraging even further snooping beyond that which is expressly authorized.

The Currency and Foreign Transactions Act should also be considered in the context of the international monetary policy of the United States. The American dollar is the leading reserve and trading currency in the world; this is due in part to the long-standing American conviction that currency restrictions of any kind are anathema. Holders have rested assured that their dollars could be readily deposited in and withdrawn from United States banks, and converted into other currencies without limitations. The Act does not impose currency restrictions by any means. It does, however, bespeak a new United States anxiousness to exercise *some* control over the flow of dollars in and out of the United States, which could be interpreted by the international financial community as a harbinger of restricted dollar liquidity. In the wake of recent blows to the prestige of the dollar, the United States would seem ill-advised to pursue any policy which might reflect anything less than an unqualified commitment to continuing dollar convertability.

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