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Seeking Swiss Assistance in Enforcing United States Tax Laws

by

Walter Müllhaupt†

INTRODUCTION

The United States assesses taxes on the entire income of a U.S. citizen, whether earned in the United States or abroad. Accordingly, seeking cooperation from foreign governments in enforcing its tax laws is a high priority of the United States government. This Article examines the extent of Swiss cooperation with requests by the Internal Revenue Service of the United States (hereinafter the IRS) for judicial aid in its investigations of American tax offenders. It delineates those circumstances in which Swiss judicial and administrative authorities will grant assistance, including enforcement procedures, in cases of tax evasion or tax fraud by U.S. citizens.

Part I of this Article surveys the relevant treaty provisions and Swiss statutory law on the subject. Part II discusses the requirements for seeking Swiss judicial aid and the extent of available remedies. In addition, two special issues, bank secrecy and the attorney-client privilege, which may frustrate a foreign party’s quest for assistance from Swiss authorities are examined.

I

STATUTORY AND TREATY PROVISIONS

Swiss doctrine and judicial decisions consider governmental assistance in enforcing foreign laws to be an administrative, not a criminal, procedure.1

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Consequently, Swiss laws are not designed to provide for the conduct of foreign criminal proceedings in Switzerland. Rather, the Swiss response to requests for official assistance in enforcing foreign laws is limited to providing aid in investigating crimes that will be tried abroad.

The scope of Switzerland’s administrative assistance to foreign nations seeking to enforce their tax laws is embodied in various Swiss statutes and in several bilateral and multilateral treaties. First, however, it should be recognized that extradition for fiscal misconduct is generally foreclosed as a means of assistance. Section II of the Swiss-American treaty concerning extradition and general Swiss doctrine make this proposition clear, at least for fiscal misdemeanors. Similarly, Article 5 of the European Treaty on extradition and section 3(3) of Switzerland’s Federal Law on International Judicial Aid in Penal Matters recognize the principle of non-extradition for fiscal matters.

A. The Judicial Aid Treaty

The Treaty between Switzerland and the United States regarding Mutual Assistance in Criminal Matters (hereinafter the Judicial Aid Treaty) provides for judicial aid in fiscal matters if fiscal misdemeanors in the United States are

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4. European Convention On Extradition, Dec. 13, 1957, art. 5, 359 U.N.T.S. 274, at 280. Article 5 provides: “Extradition shall be granted, in accordance with the provisions of this Convention, for offences in connection with taxes, duties, customs and exchange only if the Contracting Parties have so decided in respect of any such offence or category or offences.” Id. (emphasis added)


States are committed by participants in organized crime.\(^7\) When such organized crime is at issue, Swiss assistance is permitted not only in cases of tax fraud, but also when simple tax evasion is involved.\(^8\)

**B. The U.S.-Swiss Double Tax Treaty**

The U.S.-Swiss Convention for the Avoidance of Double Taxation (hereinafter the Double Tax Treaty),\(^9\) provides one foundation upon which the IRS may base a request for cooperation from Swiss tax authorities. Article 16 of the Double Tax Treaty provides that the tax authorities of each country shall exchange such information as is necessary for the carrying out of the provisions of the treaty and, more specifically, for the prevention of fraud regarding those taxes within the scope of the convention. The Swiss Federal Supreme Court, in two landmark decisions, has interpreted these provisions narrowly to allow IRS access to information, but not to documentary evidence.

The first decision\(^10\) involved a case of alleged tax fraud. In pursuing its investigation of the fraud, the IRS sought access to documents held by a Swiss bank. It specifically requested the Federal Tax Administration (hereinafter the FTA) to lend assistance in obtaining the documents or providing the relevant information. During FTA hearings it was determined that tax fraud had occurred, and the FTA accorded assistance to the IRS. The Swiss Federal Supreme Court, on appeal by the defendant (a U.S. citizen), found that the allegations of tax fraud had been proven in the hearings before the FTA and held that the bank in question could not invoke the privilege to refuse testimony under the Swiss Bank Secrecy Laws. Therefore, the court affirmed the order requiring the FTA to assist the IRS. However, the order did not grant the IRS direct access to the documentary evidence it desired. Instead, it merely required the FTA to provide the IRS with a written report of the FTA proceedings.

The second Supreme Court case\(^11\) discussing the Double Tax Treaty involved further requests for Swiss assistance in the wake of the above decision. In that case, the IRS, not satisfied with the report submitted by the FTA, sought access to the documentary evidence held by the bank. The IRS claimed that the FTA report did not constitute evidence that could be used to

\(^7\) See \textit{Zuppinger}, supra note 3, at 15; \textit{Schultz}, supra note 1, at 27; \textit{Locher}, supra note 3, at 100; \textit{Aubert}, supra note 3, at 351; \textit{Frei}, \textit{Die Rechtshilfe bei Abgabebetrug gemäss Art. 3 Abs. 3 des neuen Rechtshilfegestzes (IRSG)}, 50 ARCHIV FUR SCHWEIZERISCHES ABGABERRECHT 337, 338 (1982); \textit{Trinkler}, \textit{Die Behandlung Von Rechtshilfeersuchen in Fiskalstrafsachen im Kanton Zürich nach dem IRSG}, 40 STEUER REVUE 193, 194 (1985).

\(^8\) \textit{Zuppinger}, supra note 3, at 15.

\(^9\) Convention for the Avoidance of Double Taxation with Respect to Taxes on Income, May 24, 1951, United States-Switzerland, 2 U.S.T. 1751, T.I.A.S. No. 2316.

\(^10\) 96 BGE I 737 (1970).

\(^11\) 101 BGE Ib 160 (1975).
prove fraud in proceedings before an American court of law. The court denied this second request, relying primarily on three rationales. First, Article 16 of the Double Tax Treaty explicitly states that the FTA is required to submit only information, not documentary evidence, to the IRS. Next, citing Article 2(a) of the European Convention on Mutual Assistance in Criminal Matters, as well as general Swiss doctrine, the court held that judicial aid in fiscal matters is not required in the context of criminal proceedings such as the one in question. Finally, the court reconfirmed that the Judicial Aid Treaty could be invoked only in cases involving organized crime and thus was not applicable here. This decision of the Federal Supreme Court has prompted much criticism from commentators, particularly from those outside of Switzerland.

C. The Swiss Federal Statute on International Judicial Aid in Penal Matters (IRSG)

After the Supreme Court handed down these two decisions, the Swiss Federal Assembly enacted the Swiss Federal Statute on International Judicial Aid in Penal Matters (hereinafter the IRSG). This statute controls when, and to what extent, assistance will be granted to the United States to further its investigations into tax violations. The IRSG may possibly alter the positions expressed by the Federal Supreme Court. It is unclear at this date, however, whether the courts will apply the IRSG retroactively.

The general effect of the IRSG, as stated in section 3(3), is to limit Swiss assistance to foreign investigations of cases involving tax fraud, and cases involving tax evasion are excluded from the scope of the operation of the statute. As will be seen, therefore, it is only after tax fraud has been proven to exist under Swiss law that U.S. authorities can invoke the IRSG and seek Swiss assistance. The critical issue, then, is what constitutes tax fraud for purposes of section 3.

Under the Ordinance of the Swiss Federal Council accompanying the Swiss Law on International Judicial Aid in Penal Matters, “tax fraud” is defined by reference to section 14(1) of the Federal Law on Administrative

12. European Convention on Mutual Assistance in Criminal Matters, Apr. 20, 1959, art. 2(a), 472 U.N.T.S. 185, at 186. Article 2(a) provides: “Assistance may be refused: (a) if the request concerns an offence which the requested Party considers a political offence, an offence connected with a political offence, or a fiscal offence.” Id.

13. See Aubert, supra note 3, at 353; Menétry, supra note 3, at 452; Locher, supra note 3, at 102; Schultz, supra note 1, at 25.

14. IRSG, supra note 5.

15. See Von Siebenthal, Ausländische Reaktionen auf die neue schweizerische Rechtshilfepraxis bei Abgabebetrug, 40 STEUER REVUE 327, 334 (1985).


17. SR 351.11, § 24 (1982).
Penal Procedure. 18 According to this section, tax fraud is any willful and intentional conduct of the taxpayer, done with malice, causing the authorities charged with the administration of the tax laws to make errors that lead to massive tax evasion. 19 This notion of tax fraud is analogous to the definition of general fraud provided in the Swiss Penal Code. 20

Under this definition, the use of forged documents exemplifies the clearest case of tax fraud. Whether the primary purpose of the forgery is to accomplish tax evasion or some other goal is irrelevant; it is sufficient that the use of forged documents has the effect of evading taxes. 21 It must be noted, however, that under Swiss law tax declaration forms are not considered "documents" for purposes of the IRSG.

To resolve the question of whether tax fraud has occurred, and thus if Swiss assistance will be granted, Swiss authorities rely on this definition of tax fraud under Swiss law. 22 In resolving the issue, as noted, Swiss scholars distinguish between tax fraud on the one hand, and less important tax law misdemeanors and infractions on the other. Examples of the latter are tax evasion, the submission of false tax declarations, tax circumvention, and the like. 23 Nonetheless, in practice there is often a delicate distinction between a finding of fraud and a finding of a lesser tax offense.

Swiss jurists would fail to find tax fraud as defined in Switzerland, and would deny assistance to U.S. authorities, in the following cases. First, transfer-pricing through the use of a Swiss entity does not per se constitute tax fraud, but may be regarded as simple tax evasion. 24 Second, payment of excessive interest to a Swiss company on loans extended by it was likewise found not to be tax fraud. 25 On the other hand, tax fraud has been found to exist in a variety of cases where the use of forged documents resulted in tax law violations. For example, where a taxpayer enters fictitious transactions into his accounting books, tax fraud has occurred, since the books are "documents" under Swiss law. 26 Moreover, both payments into a Swiss company based on forged labor contracts 27 and reduction of taxable income through the use of false bills 28 have been held to be tax fraud. In sum, a finding of tax fraud is the first stage of seeking Swiss assistance, and the scope of the definition of tax fraud under Swiss law is therefore critical.

19. For further discussion of this section, see Frei, supra note 7, at 343; Widmer, supra note 16, at 518; Von Siebenthal, supra note 15, at 331; Zuppinger, supra note 3, at 27.
22. See supra note 18 and accompanying text; Frei, supra note 3, at 188; Aubert, supra note 3, at 354.
23. Zuppinger, supra note 3, at 28; Widmer, supra note 16, at 524.
24. Frei, supra note 3, at 189.
25. Trinkler, supra note 7, at 199.
26. Frei, supra note 3, at 190.
27. Id.
28. Id. at 191.
D. Analysis

The IRSG provides a broad and significant source of Swiss assistance to tax fraud investigations conducted by the United States. As noted, the Legal Aid Treaty between the United States and Switzerland has been construed to apply only in cases involving organized crime. Furthermore, although Article 16 of the Double Tax Treaty, as well as the Swiss Supreme Court cases interpreting it, do offer one avenue by which to seek Swiss judicial aid, such assistance is expressly limited to informational reports. Overall, the IRSG represents the most promising source of Swiss assistance.

A majority of Swiss scholars agree that the IRSG provisions dealing with tax fraud override previously enacted statutory and treaty provisions, including Article 16 of the Double Tax Treaty. Further reaffirming the significance and credibility of the IRSG is the firm commitment of the Swiss Federal Government to the policies reflected in and advanced by the statute. Primary among these policies is the belief that Swiss authorities should cooperate with foreign tax agencies. The legislative history of the IRSG makes clear the underlying rationale: to improve Switzerland's international image as a responsible financial center.

II

OBTAINING SWISS ASSISTANCE

The remainder of this Article discusses three features of obtaining aid from Swiss authorities. First, the formal and substantive prerequisites to invoking the IRSG are surveyed briefly to determine how foreign tax agencies may gain access to information held in Switzerland in order to prosecute tax violators. Next, the type of available assistance provided by Swiss authorities is discussed. Finally, two Swiss doctrines that may potentially hinder the execution of requests for assistance under the IRSG are noted.

A. Requirements for Seeking Assistance

According to section 28 of the IRSG, three conditions must be met before Swiss authorities will honor a request for assistance by foreign tax enforcement agencies: (1) a formal request; (2) a finding of a concomitant Swiss tax violation; and (3) a showing that the assistance obtained will be used only in the transaction for which the information was initially sought (the principle of speciality). The party seeking assistance from Swiss authorities must also file the request before certain Swiss statutes of limitations have run.

The first requirement for obtaining Swiss assistance, a formal request, must be submitted by a foreign agency to the Federal Office of Police. The

29. Locher, supra note 3, at 109; Frei, supra note 7, at 43; Aubert, supra note 3, at 354; Widmer, supra note 16, at 516; Schultz, supra note 1, at 17–18; contra De Capitani, supra note 1, at 386.

30. IRSG, supra note 5, at § 78.
request must contain the names of the party seeking assistance and the com-
petent authorities that are conducting the criminal proceedings for which
assistance is sought, the reasons why Swiss judicial aid is required, a short
description of the pertinent facts of the case and the misdemeanor charged,
and the name and address of the defendant in the proceedings.\footnote{31} Swiss au-
thorities may demand that requests failing to meet these formal requirements
be re-submitted in proper form.\footnote{32}

Upon receipt of a properly drawn request, the Federal Office of Police
submits it to the appropriate Cantonal authorities for execution.\footnote{33} If, for ex-
ample, the Canton of Zurich is involved, the District Attorney, as the appro-
priate authority, is under an obligation to again establish that all formal
prerequisites for the granting of Swiss assistance have been met. If the for-
malities have been satisfied, the request is executed and the District Attorney
returns the completed file to the Federal Office of Police. This office, in turn,
forwards it to the original party seeking assistance.\footnote{34}

Assuming that the request is properly constructed, the party seeking
assistance must then show that the misdemeanor with which the defendant is
charged is a punishable crime in Switzerland as well as in the requesting
country. As previously noted, tax fraud as defined under Swiss law would
meet this mutual punishability requirement, although simple tax evasion
would not. To determine whether the crime charged is a punishable offense
in Switzerland, Swiss authorities will rely on the facts contained in the formal
request unless they are obviously misleading or erroneous; no independent
assessment of the case will be made. In the case of tax fraud, for example,
Swiss authorities will decide whether the case as presented would beyond a
doubt also constitute an actionable case of tax fraud in Switzerland.\footnote{35}

The third requirement to be met is the principle of "speciality" as
prescribed in section 67 of the IRSG. This principle requires that the use of
the information provided by Swiss authorities be restricted to proceedings
involving the specific misconduct alleged in the initial request.\footnote{36} Swiss au-
thorities, therefore, may make such restricted use of proffered information an
express condition to the granting of the request. Under this condition, a for-
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Finally, a party seeking judicial assistance from Switzerland must meet
the relevant statute of limitations. This requirement emerges logically from
the second: the offense with which the defendant is charged must be a crime

\footnotes{
31. \textit{Id.}
32. Frei, supra note 3, at 191.
33. Trinkler, supra note 7, at 193; Frei, supra note 7, at 345.
34. Frei, supra note 3, at 191.
35. Frei, supra note 7, at 341. \textit{See also} 103 BGE Ia 629 (1977); 96 BGE I 743 (1970); 109

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punishable in Switzerland.\textsuperscript{37} Swiss law again applies in resolving this issue. In the case of assistance requested for investigations into tax fraud, for example, the applicable Swiss statute of limitations is five years.\textsuperscript{38} Therefore, requests for assistance in cases of tax fraud not made within five years of the alleged fraud are summarily denied.

Finally, despite the satisfaction of all of the requirements discussed above, the defendant taxpayer may follow several procedures to contest the requested assistance. First, the defendant may be represented by a Swiss attorney.\textsuperscript{39} Second, objections to initial rulings of the Federal Office of Police regarding the initial request may be filed within ten days of receiving the decision.\textsuperscript{40} Subsequent rulings by both the Federal Office of Police and the highest Cantonal authorities may be appealed to the Federal Supreme Court.\textsuperscript{41} Finally, Cantonal proceedings may be subject to the specific statutory provisions of the Canton. For instance, in the Canton of Zurich a specific section of the Zurich Code on Penal Procedures\textsuperscript{42} allows rulings of the District Attorney to be appealed to the Attorney of State of the Canton of Zurich.

\textbf{B. The Extent of Swiss Assistance Available}

Once Swiss authorities have formally determined that judicial aid will be offered to foreign investigations of tax fraud, it remains to be asked how much and what type of assistance is available. In cases of fraud, section 3(3) of the IRSG limits the permissible remedies Swiss authorities may grant. In addition, Swiss authorities require specificity: an overly-broad search request will be denied.\textsuperscript{43} This Section discusses the Swiss denial of attachment as a remedy, and the availability of information concerning third parties doing business in or having ties to Switzerland.

The IRSG restricts judicial aid to the collection of proof, the submission of documents, the hearing of witnesses, and the search of persons and premises,\textsuperscript{44} and expressly excludes the right of seizure or attachment of funds, in line with general Swiss legal doctrine.\textsuperscript{45} In addition, the Federal Office of Police has enacted internal regulations consistent with this position.\textsuperscript{46} It is generally recognized that countervailing principles of privacy mandate the prohibition against the attachment of funds. One scholar has written: "Who

\begin{itemize}
\item \textsuperscript{37} De Capitani, \textit{supra} note 1, at 417; 96 BGE I 744 (1970).
\item \textsuperscript{38} See \textit{Federal Law on Administrative Penal Procedure}, \textit{supra} note 18, § 11.
\item \textsuperscript{39} IRSG, \textit{supra} note 5, § 21.
\item \textsuperscript{40} \textit{Id.} § 24.
\item \textsuperscript{41} \textit{Id.} § 25; 110 BGE Ib 84 (1984).
\item \textsuperscript{42} Zurich Code on Penal Procedures, May 4, 1919; 321 ZGS (Zürcher Gesetzessammlung) § 402(1).
\item \textsuperscript{43} Trinkler, \textit{supra} note 7, at 195.
\item \textsuperscript{44} IRSG, \textit{supra} note 5, § 63.
\item \textsuperscript{45} IRSG, \textit{supra} note 5, at § 3(3). \textit{See also} Menétrrey, \textit{supra} note 3, at 462; Frei, \textit{supra} note 3, at 187.
\item \textsuperscript{46} VPB (Verwaltungsentscheide der Bundesbehorden) (1982) 46/IV No. 68 383.
\end{itemize}
disposes of funds in Switzerland need not worry that the fiscal authorities of his home country may directly attach such goods by the means of international judicial aid." 47

A final justification for the denial of attachment as a remedy is the fact that in Europe it is generally acknowledged that judgments in cases of tax law violations of one country may not be executed in another. 48 By analogy, the IRS would have no legal means by which to attach funds in Switzerland based on a judgment rendered in the United States. 49

Under certain conditions, Swiss authorities will make available information concerning third parties. Suppose that the IRS has reason to believe that the defendant taxpayer has links to third parties doing business in Switzerland, such as through a bank account in a Swiss bank. Would Swiss authorities honor a request for information concerning this bank? Section 10(1) of the IRSG provides that once the party seeking Swiss assistance has shown that significant tax fraud exists and that information about third parties is essential to the successful prosecution of the case, a formal request for such information may be honored. 50 "Third party", within the meaning of the IRSG, may be any company, including banks, doing business in Switzerland. Assuming the proper links are documented, Swiss authorities are inclined to grant requests for information concerning third parties.

The Swiss Federal Supreme Court, in several cases, has confirmed this general proposition: acquiring evidence about third parties is possible. 51 To obtain such third party information, moreover, the IRS need not claim that the third party in question has taken an active role in the tax fraud nor that the defendant-taxpayer maintains anything more than a business relationship with the third party. 52 Thus, in the above example, once the original tax fraud has been proven, it need only be shown that the defendant has made payments into a Swiss bank account. Further, if the IRS is aware only of the existence of a bank account in Switzerland, it may even request Swiss assistance in tracing the identity of the account holder. 53

One should note that Article 10(2) of the Judicial Aid Treaty also provides for the acquisition of third party information, unless the third party "appears not to be connected in any way with the offense which is the basis of the request." 54 What is required under Article 10(2), therefore, is merely an

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47. Frei, supra note 3, at 187.
48. Menétry, supra note 3, at 462; Frei, supra note 3, at 187; Locher, supra note 3, at 100; Zuppinger, supra note 3, at 40.
49. Locher, supra note 3, at 100.
50. IRSG, supra note 5, § 10(1). See also 110 BGE Ib 173 (1984).
51. See, e.g., 110 BGE Ib 173 (1984); 110 BGE Ib 83 (1984); 110 BGE Ib 49 (1984); 107 BGE Ib 254 (1981); 107 BGE Ib 258 (1981); 105 BGE Ib 429 (1979).
52. Schmid, Frei, Wyss, & Schouwey, supra note 1, at 334. See also De Capitani, supra note 1, at 460.
54. See Judicial Aid Treaty, supra note 6, § 10(2). See also 107 BGE Ib 254 (1981).
objective connection, not proof that the third party is an accomplice of the defendant.55

C. Two Special Issues in Switzerland

Two caveats, based on special features of Swiss law, must be made here, for such features can impede the full execution of a foreign request for assistance under the IRSG. These two critical considerations are the Swiss bank secrecy provisions and the attorney-client privilege.

The secrecy to which a client of a Swiss bank is entitled is qualified, not absolute. In criminal matters, of which tax fraud is one, the bank's right to assert its privilege to withhold evidence or testimony may be overridden; the decision is made in accordance with the applicable cantonal codes of penal procedure.56 In practice, the protection of the bank secrecy laws is lifted in many cases where a request for assistance in a tax fraud investigation would be honored under the IRSG. In Zurich, for example, this is true. Only three Cantons—Fribourg, Vaud and Neuchâtel—allow banks to assert the privilege in such cases.

The second privilege that may potentially interfere with the execution of requests for assistance under the IRSG is the protected status of attorney-client. Unlike the Bank Secrecy Laws, however, the professional privilege of the attorney to refuse to testify against a client is generally upheld in criminal proceedings. All Cantonal Codes of Procedure are in accord.57 One limited exception is available: if an attorney serves on the Board of Directors of a corporation owned by the client, the attorney cannot invoke the attorney-client privilege in matters regarding the corporation's business.58

CONCLUSION

The IRS may request judicial aid from Swiss authorities in matters of tax fraud as defined in Switzerland, provided that the applicable statute of limitations has not run. The scope of available assistance as laid out in several treaty provisions and Swiss statutes limits aid to information and document exchange and specifically excludes extradition as a remedy. Furthermore, two decisions rendered by the Swiss Federal Supreme Court have interpreted these treaty provisions to allow for the supply of information, but not the physical documentary evidence itself.

55. Schmid, Frei, Wyss, & Schouwey, supra note 1, at 334. See also Schultz, supra note 1, at 26; De Capitani, supra note 1, at 460.
58. Steinmann, supra note 56, at 67.
The scope of available assistance is limited to tax fraud as opposed to tax evasion under the Swiss Federal Statute on International Judicial Aid in Penal Matters (IRSG). Judicial aid under the IRSG is limited to the submission of information and documents, the seizure of documents, and the hearing of witnesses.

The IRS may increase the likelihood of its obtaining useful information from Swiss authorities by complying with various procedural and statute of limitations requirements. However, a party seeking cooperation from Swiss authorities should be aware of various restrictions on the extent of available Swiss assistance. Attachment of assets to cover overdue taxes is generally denied as a remedy, although information about third parties is available under certain conditions. In practice, a request for assistance which is received favorably under the IRSG may override bank secrecy privileges. A Swiss attorney-client privilege, however, may obstruct a request for judicial aid unless the attorney has acted as a member of the board for a company belonging to the incriminated taxpayer.