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THE NEW TAX INFORMATION EXCHANGE AGREEMENT: A POTENT WEAPON AGAINST U.S. TAX FRAUD?

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I. INTRODUCTION

On October 2, 1996, after sixteen (16) years of negotiation,[1] the U.S. signed a new tax treaty with Switzerland ("1996 Agreement").[2] On January 23, 2003, the 1996 Agreement was amended ("2003 Agreement"). The 2003 Agreement established new guidelines on how to properly implement Article 26[3] (pertaining to information sharing) of the Convention between the U.S. and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income.[4] Both Agreements

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1. Agence France-Presse, *U.S. Seeks to Revise 1996 Swiss Tax Treaty*, 27 TAX NOTES INT'L 793 (Aug. 12, 2002) [hereinafter *U.S. Seeks to Revise 1996 Swiss Tax Treaty*].

2. W. Warren Crowdus, *U.S., Switzerland Sign Income Tax Treaty*, 13 TAX NOTES INT'L 1983 (Dec. 16, 1996) [hereinafter *U.S., Switzerland Sign Income Tax Treaty*].

3. "The agreement focuses on interpretation of Article 26 of the U.S.-Swiss treaty, dealing with exchange of information between competent authorities, and paragraph 10 of the accompanying protocol, which addresses the definition of tax fraud." James P. Fuller, *Jim Fuller's U.S. Tax Review*, 29 TAX NOTES INT'L 785 (Feb. 24, 2003).

4. On January 23, 2003, the U.S. and Swiss competent authorities entered into a mutual agreement under the current Switzerland-United States income tax treaty that is intended to facilitate more effective tax information exchange between the two countries.

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attempt to strengthen each government's respective ability to combat tax fraud. The 2003 Agreement clarifies the 1996 Agreement and provides guidance as to what constitutes "tax fraud" under the agreements by providing fourteen (14) hypothetical situations that constitute tax fraud.[5] According to Kenneth W. Dam,[6] acting Treasury Secretary, and Pamela Olson,[7] Treasury Assistant Secretary for Tax Policy, both agreements were reached to prohibit and catch tax evasion by strengthening information sharing between the two countries.[8]

Press Release, U.S. Dept. of the Treas., Office of Public Affairs, Treasury Announces Mutual Agreement with Switzerland Regarding Tax Information Exchange (Jan. 24, 2003) (on file with the Houston Business and Tax Law Journal and available at http://www.ustreas.gov/press/releases/kd3795.htm) (including the text of the Mutual Agreement, Letter from Acting Treasury Secretary Kenneth Dam, and Letter from Swiss Finance Minister Kaspar Villiger) [hereinafter Treasury Announces Mutual Agreement with Switzerland Regarding Tax Information Exchange].

5. Alison Bennett, *U.S., Switzerland Reach Mutual Agreement On Civil, Criminal Tax Information Exchange*, DAILY TAX REPORT, Jan. 27, 2003, at GG–1 (stating:

> the agreement clarifies expected responses to state requests for tax information in the effort to prevent tax fraud. It also sets out a detailed description of conduct that would constitute tax fraud, as well as the factors on which a "reasonable suspicion" of fraud should be based.
>
> In addition, the document sets out 14 hypothetical examples of conduct that would be considered tax fraud.).

6. Kenneth W. Dam stated that "[t]his Mutual Agreement is a significant step in our efforts to ensure that no safe haven exists anywhere in the world for the funds associated with illicit activities, including tax evasion. I look forward to continuing progress with Switzerland and other financial centers in this important area." Treasury Announces Mutual Agreement with Switzerland Regarding Tax Information Exchange, *supra* note 4.

7. *See id.* (containing a statement by Pam Olson that:

> [a]ccess to needed information is vital to our efforts to ensure full and fair enforcement of our tax laws . . . . This Mutual Agreement should improve our access to needed information under the current bilateral tax treaty between the United States and Switzerland. We look forward to working with Switzerland to further improve this relationship.
>
> Treasury is committed to continuing its efforts to improve and expand the U.S.'s broad network of bilateral tax treaties and tax information exchange agreements . . . . Better tax information exchange relationships will permit the IRS to obtain the information it needs from other countries so it can pursue taxpayers attempting to hide income offshore to avoid their tax obligations).

8. Cynthia Shelton, Marnin Michaels, Stephanie Jarrett, & Denis Bedroz, *Switzerland and U.S. Agree to Swap Tax Information*, 14 J. INT'L TAX'N 54 (Apr. 2003) (stating:

> Article 26 (Exchange of Information) of the treaty, which was signed on October 2, 1996, and entered into force on December 19, 1997, provides that the Competent Authorities of the U.S. and Switzerland will exchange such information as is necessary "for the prevention of tax fraud or the like in relation to the taxes which are the subject of" the treaty. Under the Agreement, the exchange of information will be in regard to both civil and criminal matters. The statute of limitations

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The focus of this paper is to discuss certain points of the 1996 Agreement and the 2003 Agreement, followed by a discussion of what Switzerland and U.S. officials think about the possible long-term effects of the new amended 2003 Agreement.

II. THE 1996 TAX INFORMATION EXCHANGE ACT

The U.S. and Switzerland signed the 1996 Agreement on October 2, 1996[9] as part of a comprehensive undertaking on the part of the U.S. to update all their existing tax treaties at that time.[10] The 1996 Agreement superseded the original tax treaty of 1951 between the U.S. and Switzerland.[11] The 1996 Agreement was quite extensive. While all of its sections are relevant, this part of the paper will specifically focus on two of the more important areas covered in the 1996 Agreement: the benefits clause[12] and the information sharing requirement found within Article 26.[13]

A. *The Benefits Clause*

One of the most important features of the 1996 Agreement was the limitation on the Benefits Clause. Essentially the limitation on benefits means:

> applicable under the laws of the requesting country will apply, instead of the statue of limitation of the requested country).

9. *See U.S., Switzerland Sign Income Tax Treaty*, *supra* note 2, at 1983. On October 2, 1996, the governments of the United States and Switzerland signed a new income tax treaty between the two countries. *Id.*

10. *See id.* (stating:

> From the perspective of the U.S. government, the 1996 treaty is a critical element of an ongoing initiative to update a number of existing tax treaty relationships. This initiative has focused on treaty partners that were seen as fostering environments that were hospitable to "treaty shoppers," i.e., investors from countries with either no U.S. tax treaty or a treaty with relatively high rates of withholding tax who sought countries with two chief characteristics: a favorable tax treaty with the United States (and probably other countries as well), and a fiscal environment that permits establishment of holding company or conduit structures that bear little tax in the country where they are established).

11. *Id.* For the full text, *see U.S.-Switzerland Income Tax Convention and Protocol, Signed October 2, 1996, With a Related Memorandum of Understanding* 96, TAX NOTES INT'L 194–41 (Oct. 4, 1996) [hereinafter 1996 Treaty]. "The convention will enter into force upon exchange of ratification instruments and will supersede the U.S.-Switzerland income tax convention signed on May 24, 1951." *Id.* Its provisions will apply with respect to taxes payable at the source from the first day of the second month following its entry into force, and with respect to other taxes from the first day of January following its entry into force. *Id.*

12. *Id.*

13. *Id.*

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> A resident of a contracting state that derives income from the other state may claim the benefits of the treaty only to the extent that the person is described in one of a number of safe harbors set forth in the article, or if the competent authority of the source state determines to grant discretionary relief.[14]

More or less this section purports to limit the persons who may be eligible to claim benefits under the 1996 Agreement.[15] There are seven (7) categories of persons who may be eligible.[16] The first category defined in the 1996 Agreement "is an individual."[17]

The second category is a member of the contracting country.[18] The third category provides that one must be engaged in an active trade or business in one of the contracting countries.[19] However, to be eligible under the third category, a person must generally meet the trade or business test. Generally under this test:

> [A] Swiss resident will be entitled to treaty benefits with respect to U.S.-source income that is derived in connection with the conduct of an active trade or business conducted in Switzerland. In addition, if the income is derived from a related party (defined as 10 percent or more ownership), the trade or business in Switzerland must be "substantial" in relation to the activity in the United States that gave rise to the income.[20]

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14. *U.S., Switzerland Sign Income Tax Treaty*, *supra* note 2, at 1987.

15. *See* 1996 Treaty, *supra* note 11 (stating "[s]ubject to the succeeding provisions of this Article, a person that is a resident of a Contracting State and that derives income from the other Contracting State may only claim the benefits provided for in this Convention . . . . ").

16. *Id.*

17. *Id.*

18. *Id.* (explaining that a contracting country is "a Contracting State, a political subdivision or local authority thereof, or an agency or instrumentality of such State, political subdivision or authority.").

19. *Id.* (explaining that engaged in business means:

> engaged in the active conduct of a trade or business in the first-mentioned Contracting State (other than the business of making, managing or simply holding investments for the person's own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance company or registered securities dealer) and the income derived from the other Contracting State is derived in connection with, or is incidental to, that trade or business).

20. *U.S., Switzerland Sign Income Tax Treaty*, *supra* note 2, at 1988. Further

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The fourth category "is a recognized headquarters company for a multinational corporate group."[21] The fifth category is a company.[22] However, it should be noted that there are exceptions to this category.[23] The sixth category involves companies, trusts and estates.[24] The seventh and final category of eligible persons is a specific family foundation under Swiss law.[25]

B. *Article 26 and Information Sharing*

One of the most contentious parts of the 1996 Agreement between the U.S. and Switzerland was the information sharing requirement. Information sharing for Switzerland is contentious because, "Switzerland has, for many years, had a philosophical difference with the United States and most of its OECD brethren with respect to the appropriate scope of an income tax treaty."[26]

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commentary reveals that:

> the Swiss treaty provides in the protocol that whether a trade or business is substantial will be determined based on all the facts and circumstances. Factors to consider in this determination include the "comparative sizes" of the activities in the two states (measured by reference to assets, income, and payroll), the nature of the activities performed, and the relative contributions made to that trade or business in each state. The protocol also provides that "due regard" will be given to the relative sizes of the U.S. and Swiss economies.
>
> A second distinction between the Swiss provision and other treaties is that the definition of an active trade or business specifically provides that making, managing, or holding investments will constitute an active trade or business if such activities are "securities activities" carried on by a "registered securities dealer."

Id.

21. 1996 Treaty, *supra* note 11.

22. *Id.*

23. *Id.* (explaining that under the convention a company is eligible under two limitations, those being "i) whose principal class of shares is primarily and regularly traded on a recognized stock exchange; or ii) if one or more companies described in clause i) are the ultimate beneficial owners of a predominant interest in such company.").

24. *Id.* (explaining that one qualifies if one is a company, trust or estate, unless one or more persons who are not entitled to the benefits of this Convention under subparagraphs a), b), d), e) or g) are, in the aggregate, the ultimate beneficial owners of a predominant interest in the form of a participation, or otherwise, in such company, trust or estate.).

25. *Id.* (explaining that one qualifies if one is a family foundation resident in Switzerland, unless the founder, or the majority of the beneficiaries, are persons who are not entitled to the benefits of this Convention under subparagraph a), or 50 percent or more of the income of the family foundation could benefit persons who are not entitled to the benefits of this Convention under subparagraph a).).

26. *U.S., Switzerland Sign Income Tax Treaty*, *supra* note 2, at 1991. *See also* Martin Gelnar, *Swiss Economics Minister Reconfirms Bank Secrecy's Future*, 21 TAX NOTES INT'L 2898 (Dec. 25, 2000) (noting that "Swiss Economics Minister Pascal Couchepin reconfirmed recently that Switzerland would not give up its banking secrecy laws in upcoming negotiations with the European Union, according to the Swiss biweekly

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Switzerland, as a "country of bankers," is very protective of its information, especially financial information.[27] Previous treaties between the U.S. and Switzerland have contained information exchange provisions but the U.S. generally has been unhappy with the amount of information they were allowed to receive from the Swiss.[28] The U.S. believed that the 1996 Agreement with the Swiss would provide for greater information sharing, thus enabling the U.S. to combat tax fraud more effectively.[29] However, as evidenced by the later amendment to the 1996 Agreement in 2003, the U.S. eventually decided that the 1996 Agreement did not provide for enough information sharing between the two countries.

One interesting facet of Article 26 is the fact that while it was designed to prevent tax fraud between the two countries by encouraging information sharing between the U.S. and Switzerland, the Article failed to define what constitutes "tax fraud."[30] Instead, one had to look to the protocol of the 1996 Agreement for the definition of "tax fraud."[31] The general definition provided that "the term 'tax fraud' means fraudulent conduct that causes or is intended to cause an illegal and substantial reduction in the amount of tax paid to a Contracting

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Finanz und Wirtschaft. His comments were similar to those made earlier by Finance Minister Kaspar Villiger.").

27. *See U.S., Switzerland Sign Income Tax Treaty*, *supra* note 2, at 1991 (stating that "[a] major contributor to this difference between Switzerland and most other countries is the Swiss desire to preserve bank secrecy.").

28. *Id.*

> While the 1951 treaty contains an exchange of information article, U.S. tax authorities have, for many years, expressed frustration that they were unable to use this provision to pierce the veil of Swiss bank secrecy, even in criminal cases. While the treaty expressly provides for access to information in connection with fraud, the United States found that the Swiss notion of fraud was narrower than the U.S. notion. An additional problem in U.S. eyes was that even if the Swiss would provide 'information,' Swiss courts did not interpret the treaty as requiring them to provide original documents, the lack of which made successful prosecutions difficult.
>
> The situation improved somewhat in 1982, when internal Swiss legislation enabled foreign tax authorities to obtain information through Swiss judicial channels in connection with criminal tax fraud investigations. However, the definition of tax fraud for purposes of this legislation continued to be the Swiss concept, and the request had to proceed through Swiss judicial channels.

Id.

29. *Id.* (stating that "Article 26 of the 1996 treaty, in conjunction with the memorandum of understanding and protocol, appears to represent a step forward from the U.S. (and OECD) point of view").

30. *See generally* 1996 Treaty, *supra* note 11.

31. *Id.*

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State."[32] Commentators have suggested that this section of the protocol provides two categories of tax fraud.[33] One commentator stated:

> Specifically, paragraph 10 creates two independently sufficient categories of actions that constitute tax fraud for purposes of the treaty, one of which is independent of the laws of either state, and one of which is dependent on the laws of the requested state. First, tax fraud is understood to include situations when a taxpayer uses any false piece of documentary evidence, or 'a scheme of lies' that is intended to deceive. Second, it also includes any other conduct that constitutes fraudulent conduct under the laws of the requested state. The first category, which applies regardless of whether the conduct constitutes fraudulent conduct under the laws of the requested state, undoubtedly was of critical importance to U.S. negotiators.[34]

The protocol then further defined what would constitute fraudulent conduct as:

> [A]ssumed in situations where a taxpayer uses, or has the intention to use, a forged or falsified document such as a double set of books, a false invoice, an incorrect balance sheet or profit and loss statement, or a fictitious order or, in general, a false piece of documentary evidence, and in situations where the taxpayer uses, or has the intention to use, a scheme of lies ("Lugengebaude") to deceive the tax authorities.[35]

It should be noted that the examples listed above concerning what constituted fraudulent conduct are not exhaustive and instead were only meant to provide guidance to residents of the contracting countries.[36] The last part of the protocol provided the

32. *Id.*
33. *U.S., Switzerland Sign Income Tax Treaty*, *supra* note 2, at 1991.
34. *Id.* at 1991–92.
35. 1996 Treaty, *supra* note 11.
36. *Id.*

It is understood that the acts described in the preceding sentence are by way of illustration, not by way of limitation. The term "tax fraud" may in

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rules for record keeping between the two countries.[37]

The 1996 Agreement between the U.S. and Switzerland primarily focused on the limitations under the benefits clause. Article 26 and the sharing of information between the two countries, while mentioned and discussed within the 1996 Agreement, still took a back seat to the importance placed on the limitations that the contracting countries imposed on the benefits clause. However, in the later 2003 Agreement, the main focus of the Treaty was almost exclusively on information sharing between the two countries.

III. THE 2003 TAX INFORMATION EXCHANGE ACT

Beginning on August 6, 2002, representatives from the U.S. and Switzerland began holding meetings in which they considered revising the 1996 Agreement between the two countries.[38] Because of Switzerland's banking secrecy laws[39] the

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> addition include Acts that, at the time of the request, constitute fraudulent conduct with respect to which the requested Contracting State may obtain information under its laws or practices.

Id.

37. *Id.* The last paragraph of the protocol states:

> [i]t is understood that, in determining whether tax fraud exists in a case involving the active conduct of a profession or business (including a profession or business conducted through a sole proprietorship, partnership or similar enterprise), the requested State shall assume that the record-keeping requirements applicable under the laws of the requesting State are the record-keeping requirements of the requested State.

Id.

38. *See U.S. Seeks to Revise 1996 Swiss Tax Treaty*, *supra* note 1 (noting that:

> U.S. Treasury Secretary Paul O'Neill had requested changes in February, and Swiss Ministry of Finance officials say the meeting is being held to reconsider the treaty's exchange of information clause, Agence France-Presse reported 5 August. That follows a meeting on taxation issues between Switzerland and the European Union in which Switzerland rejected a call for full exchange of information, arguing that it would violate Swiss banking secrecy laws. Swiss banking laws forbid access to bank account details unless part of a criminal investigation. Switzerland does not consider tax evasion to be a crime, and banks do not cooperate with Swiss tax authorities. Under the treaty, which took 16 years to negotiate, the United States and Switzerland are only under limited obligation to exchange information on tax fraud, according to Agence France-Presse. The agreement precludes the exchange of information that may divulge "trade, business, industrial or professional secrets." Eric Hess, a Swiss official who works in international taxation, said that he expects the United States to seek a broader scope of the exchange of information clause. Hess also said that Swiss Finance Minister Kaspar Villiger is ready to start talks on the matter, but the talks would be confidential until the signing of a protocol).

39. *See* Michele Moser, *Switzerland: New Exceptions to Bank Secrecy Law Aimed at*

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U.S. and other countries within the European Union felt that Switzerland was not aiding other countries as effectively as it should be by providing information that could be needed for effective enforcement against tax fraud.[40] One commentator stated:

> Bank secrecy in Switzerland derives from the principle of personal privacy and reflects the value placed by Switzerland on individual economic liberties. Swiss law does not specifically define Swiss banking secrecy, but according to legal custom its definition is "a banker's professional obligation to keep in strictest confidence, all business and affairs related to the financial and personal circumstances of clients and some third parties to the extent that knowledge of such matters is acquired in the course of business."
>
> A special feature of Swiss banking secrecy is that a violation is subject to criminal prosecution. Although violations of professional secrecy are prosecuted only upon the express request of the injured party, the courts may prosecute a breach of banking secrecy on their own initiative. Because of its strict banking secrecy law Switzerland is frequently referred to as a money-haven. However, many other countries are internationally renowned as money-havens along with Switzerland. For example, the banks in Luxembourg and the Cayman Islands hold large amounts of foreign deposits. Austria and the Principality of Liechtenstein have stringent bank secrecy laws similar to those in Switzerland.
>
> . . . .
>
> Article 321 of the Swiss Penal Code states that the

Money Laundering and Organized Crime, 27 CASE W. RES. J. INT'L L. 321 (Spring/Summer 1995) (discussing the Swiss's continued resistance at easing the restrictions of their bank secrecy laws).

40. *See generally id.* at 321–41 (explaining the international pressure on Switzerland to change its banking secrecy laws). During a meeting on taxation issues between Switzerland and the European Union:

> Switzerland rejected a call for full exchange of information, arguing that it would violate Swiss banking secrecy laws. Swiss banking laws forbid access to bank account details unless part of a criminal investigation. Switzerland does not consider tax evasion to be a crime, and banks do not cooperate with Swiss tax authorities.

U.S. Seeks to Revise 1996 Swiss Tax Treaty, supra note 1.

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> actual bank secrecy provision which punishes violations of professional secrecy should be left to the Banking Code itself. Article 162 of the Swiss Penal Code applies to the non-bank sector of the Swiss financial market and prohibits financiers from disclosing commercial and business secrets. Under Article 273, dealing with "espionage and the supplying of economic information to foreign officials and private organizations," the Swiss Penal Code imposes the duty of banking secrecy on the financier under the theory that a disclosure of domestic information might harm Switzerland economically. [41]

U.S. Officials felt that it was imperative to increase the exchange of information with Switzerland, especially in light of September 11, 2001 and the U.S. war on terrorism. Furthermore, Switzerland has always been notorious as a haven for money laundering and organized crime.[42] Therefore, the U.S. requested that the Swiss renegotiate.[43] The Swiss were surprisingly willing to increase information sharing with the U.S. Their willingness, more or less, stemmed from the Swiss's growing desire to mitigate their reputation for harboring money launders and organized crime. The Swiss Banker's Association ("SBA") emphasized, in its preamble, the "view of *preserving the good name* of the Swiss banking community, nationally and internationally . . . . " and stated that "[i]n order to maintain its status as a leader in Europe's financial market, Switzerland needs to restore its tarnished image. The main factors that contribute to the urgency include money laundering problems, organized crime activities, international pressure, and the need to eliminate conflicts."[44]

On January 24, 2003, the Treasury Department announced that the U.S. and Switzerland had entered into a mutual agreement regarding the exchange of information between the two countries.[45] The new 2003 Agreement between the U.S. and Switzerland began with statements of understanding arising out

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41. *See* Moser, *supra* note 39, at 323–24.

42. *See id.* at 327.

43. *See U.S. Seeks to Revise 1996 Swiss Tax Treaty*, *supra* note 1.

44. Moser, *supra* note 39, at 327 (citation omitted).

45. "[T]he Treasury Department announced that the competent authorities of the United States and Switzerland have entered into a Mutual Agreement under the current U.S.-Swiss Income Tax Convention that is intended to facilitate more effective tax information exchange between the two countries." Treasury Announces Mutual Agreement with Switzerland Regarding Tax Information Exchange, *supra* note 4.

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of the 1996 Agreement.[46] Specifically the 2003 Agreement restates the notion that the exchanges of information was imperative for the two countries in order to effectively combat and catch tax fraud.[47]

In order to effectuate the 2003 Agreement's purpose of expanding information sharing between the two countries there are six (6) understandings agreed upon between the two countries.[48] The first understanding expounds both countries renewed effort at working together to the greatest extent possible to support the tax administration of both countries.[49] The second understanding provides that when information is requested, the statute of limitations of the requesting country will apply.[50] The third understanding provides that information can be requested for both civil and criminal prosecution.[51] The fourth understanding sets forth three (3) examples (formerly provided for in the 1996 Agreement) which establish what will constitute tax fraud between the two countries.[52] The fifth understanding

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46. *Id.*

47. *Id.* The 2003 Agreement begins with the following statement:

> [w]hereas Article 26 (Exchange of Information) of 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 at Washington on October 2, 1996, ("the Convention"), provides that the competent authorities of the Contracting States shall exchange such information as is necessary "for the prevention of tax fraud or the like in relation to the taxes which are the subject of" the Convention.

Id.

48. *Id.*

49. *Id.* (stating "[i]t is understood that Article 26 of the Convention and paragraph 10 of the Protocol will be interpreted to support the tax administration and enforcement efforts of each Contracting State to the greatest extent possible.").

50. *Id.* (stating "[i]t is understood that, in determining whether information may be provided in response to a request, the requested State shall apply the statute of limitations applicable under the laws of the requesting State instead of the statute of limitations of the requested State.").

51. Treasury Announces Mutual Agreement with Switzerland Regarding Tax Information Exchange, *supra* note 4 (stating "[i]t is understood that, in response to a request, the requested State shall exchange information with respect to matters that the requesting State is pursuing, or may pursue, on a civil or criminal basis.").

52. *Id.* The 2003 Agreement states the following:

> It is understood that the following conduct constitutes "tax fraud or the like" under paragraph 1 of Article 26 of the Convention, which is also illustrated in paragraph 10 of the Protocol:
>
> > a) Conduct that is established to defraud individuals or companies, even though the aim of the behavior may not be to commit tax fraud;
> >
> > b) Conduct that involves the destruction or non-production of records, or the failure to prepare or maintain correct and complete records, that a person is under a legal duty (tax or otherwise) to prepare and keep as sufficient to establish the amount of gross

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sets forth examples which establish when a contracting country can request information if they believe or suspect that there is tax fraud being committed.[53] The sixth understanding is the understanding that the proceeding examples within the appendix will constitute tax fraud under article 26 of the 1996 Agreement.[54] The fourteen (14) examples found within the amended Article 26 are not exhaustive and are only to be used to provide guidance for the two countries. In the 1996 Agreement, there was no definition of "tax fraud" included in the Agreement. The term "tax fraud" was only briefly mentioned in the protocol. However in the 2003 Agreement, the fourteen (14) examples provide a comprehensive illustration of what will constitute tax fraud between the two countries. A brief explanation of each of the 14 examples is discussed below.

> > income, deductions, credits, or other matters required to be shown by such person in any tax return, if the person has not properly reported such amounts in any such tax return; or
> >
> > c) Conduct by a person subject to tax in the requesting State that involves the failure to file a tax return that such person is under a legal duty to file and an affirmative act that has the effect of deceiving the tax authorities making it difficult to uncover or pursue the failure to file, including the concealment of assets or covering up of sources of income or the handling of one's affairs to avoid making the records that are usual in transactions of the kind.
>
> It is understood that these examples are by way of illustration, and not by way of limitation.

Id.

53. *Id.* The 2003 Agreement provides:

> It is understood that, in response to a request, the requested State shall exchange information where the requesting State has a reasonable suspicion that the conduct would constitute tax fraud or the like. The requesting State's suspicion of tax fraud or the like may be based on:
>
> > a) Documents, whether authenticated or not, and including but not limited to business records, books of account, or bank account information;
> >
> > b) Testimonial information from the taxpayer;
> >
> > c) Information obtained from an informant or other third person that has been independently corroborated or otherwise is likely to be credible; or
> >
> > d) Circumstantial evidence.
>
> It is understood that these examples are by way of illustration, and not by way of limitation.

Id.

54. *Id.* The Agreement further states:

[i]t is understood that each of the hypothetical examples in the Appendix below involves conduct constituting "tax fraud or the like" under paragraph 1 of Article 26 of the Convention and paragraph 10 of the Protocol. It is understood that these examples are by way of illustration, and not by way of limitation.

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The first example is somewhat obvious as it describes a situation where an individual keeps two sets of book of accounting for his or her cash transactions and an informant provides the local authorities with the two sets of books.[55]

The second hypothetical provides the same factual scenario, except the informant only provides information to the local authorities of the potential tax fraud as opposed to providing the actual books.[56]

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55. *Id.* The 2003 Agreement provides the following hypothetical:

An individual subject to the requesting State's income tax operates a business with substantial cash sales. He keeps one set of books and records in which he records all business expenses; however, he causes a substantial portion of the cash sales of the business to be omitted from this set of books. The individual keeps a second set of books and records that includes the total amount of cash sales, including the cash sales not recorded on the first set of books and records. Because the first set of business books and records are used to prepare the individual's income tax return, a substantial portion of his taxable income is not reported on the tax return. Specifically, the individual's income tax return, and the component to that return on which the individual reports business receipts, expenses, and other items related to the business, understates the gross business receipts and other income related entries.

The individual maintains a bank account in the requested State in his own name into which he deposits the portion of his business income that is not reported on his tax return. Based on information provided by an informant, including a copy of the second set of books and records that the informant secretively took from the business premises, tax officials of the requesting State commence an investigation of the individual for possible tax violations under the laws of the requesting State. The taxpayer provides the first set of books and records to these officials to support the false information on his tax return.

The requested State would obtain and provide information relating to the bank account in the requested State of the individual in response to a specific request by the requesting State under Article 26 of the Convention.

Id.

56. *Id.* Hypothetical 2 provides:

An individual subject to the requesting State's income tax operates a business with substantial cash sales. He keeps one set of books and records in which he records all business expenses; however, he causes a substantial portion of the cash sales of the business to be omitted from this set of books. The individual keeps a second set of books and records that includes the total amount of cash sales, including the cash sales not recorded on the first set of books and records. Because the first set of business books and records are used to prepare the individual's income tax return, a substantial portion of his taxable income is not reported on the tax return. Specifically, the individual's income tax return, and the component to that return on which the individual reports business receipts, expenses, and other items related to the business, understates the gross business receipts and other income related entries.

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The third hypothetical describes an individual who operates a cash only operation where he or she skims part of the proceeds and pays taxes only on the amount he or she did not skim. An informant tells authorities about the skimming and where to locate the bank account.[57]

The fourth hypothetical provides the same factual scenario,

> The individual maintains a bank account in the requested State in his own name into which he deposits the portion of his business income that is not reported on his tax return. Based on information provided by an informant, authorities of the requesting State conduct a search of the business premises and seize both sets of books and records.
>
> The requested State would obtain and provide information relating to the bank account in the requested State of the individual in response to a specific request by the requesting State under Article 26 of the Convention.

Id.

57. Treasury Announces Mutual Agreement with Switzerland Regarding Tax Information Exchange, *supra* note 4. Hypothetical 3 provides:

> An individual subject to the requesting State's income tax operates a business which provides a service on a "cash only" basis. He regularly skims a substantial portion of these cash receipts and deposits these skimmed receipts in a bank account in the requested State maintained in his own name. He deposits the remainder of his cash receipts in a bank account in the requesting State maintained in his business name. He pays his business expenses by drafting checks against the bank account in the requesting State.
>
> He files an income tax return, understating his gross income, taxable income, and tax due, to the extent that he skimmed from his business receipts. Specifically, the individual's income tax return, and the component to that return on which the individual reports business receipts, expenses, and other items related to the business, understates the gross business receipts and other income related entries.
>
> An informant tells the tax officials of the requesting State about the business, including the skimming activities, and the bank account in the requested State, specifically stating that the individual told him that he skimmed no less than 30 per cent of his gross receipts every week and deposited these skimmed receipts in an account under his name in the X Bank located in the requested State. Based on this information tax officials of the requesting State commence an investigation of the individual for possible tax violations under the laws of the requesting State. In response to a request by the tax officials of the requesting State for substantiation of the tax return, the individual provides incomplete books and records that omit the skimmed receipts and therefore support the tax return.
>
> The requested State would obtain and provide information relating to the bank account in the requested State of the individual in response to a specific request by the requesting State under Article 26 of the Convention.

Id.

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except a former employee tells the authorities about what is happening as opposed to an informant.[58]

In the fifth hypothetical, the taxpayer essentially undertakes the same transaction as in the previous two examples (examples 3 and 4), but the taxpayer does not keep records of receipts or expenses, and all the relevant information is told to authorities by an informant who specifically states that the individual told the informant that the taxpayer has been underreporting his or her income.[59]

---

58. *Id.* Hypothetical 4 provides:

> An individual subject to the requesting State's income tax operates a business which provides a service on a "cash only" basis. He regularly skims a substantial portion of these cash receipts and deposits these skimmed receipts in a bank account in the requested State maintained in his own name. He deposits the remainder of his cash receipts in a bank account in the requesting State maintained in his business name. He pays his business expenses by drafting checks against the bank account in the requesting State.
>
> He files an income tax return, understating his gross income, taxable income, and tax due, to the extent that he skimmed from his business receipts. Specifically, the individual's income tax return, and the component to that return on which the individual reports business receipts, expenses, and other items related to the business, understates the gross business receipts and other income related entries.
>
> A former employee of the business tells the tax officials of the requesting State about the business, including the skimming activities, and the bank account in the requested State, specifically stating that the individual told him that he skimmed no less than 30 per cent of his gross receipts every week and deposited these skimmed receipts in an account under his name in the X Bank located in the requested State. Based on this information tax officials of the requesting State commence an investigation of the individual for possible tax violations under the laws of the requesting State. In response to a request by the tax officials of the requesting State for the required substantiation of the tax return, the individual does not provide any books and records.
>
> The requested State would obtain and provide information relating to the bank account in the requested State of the individual in response to a specific request by the requesting State under Article 26 of the Convention.

Id.

59. *Id.* Hypothetical 5 provides:

> An individual subject to the requesting State's income tax operates a business, which provides a service on a "cash only" basis. He regularly skims a substantial portion of these cash receipts and deposits these skimmed receipts in a bank account in the requested State maintained in his own name. He deposits the remainder of his cash receipts in a bank account in the requesting State maintained in his business name. He pays his business expenses by drafting checks against the latter bank account. He keeps no record of business receipts or expenses other than his bank account records in the requesting and requested State.

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In the sixth hypothetical, the taxpayer forms a bearer share corporation and enters into an agreement with the taxpayer's company to do market research, which is never done. The taxpayer is selected for a random audit and subsequently denies ownership of the corporation.[60]

> He files an income tax return, understating his gross income, taxable income, and tax due, to the extent that he skimmed from his business receipts. Specifically, the individual's income tax return, and the component to that return on which the individual reports business receipts, expenses, and other items related to the business, understates the gross business receipts and other income related entries.
>
> An informant tells tax officials of the requesting State about the business, including the skimming activities, and the bank account in the requested State, specifically stating that the individual told him that he skimmed no less than 30 per cent of his gross receipts every week and deposited these skimmed receipts in an account under his name in the X Bank located in the requested State. The informant also tells tax officials of the requesting State that the individual has used proceeds from the bank account in the requested State to purchase assets, formal legal ownership of which has been placed in the names of other persons.
>
> Based on this information tax officials of the requesting State commence an investigation of the individual. Among other things, these officials learn that the individual used cash to buy particular assets, and has with documentation placed legal ownership to these assets in the name of other persons. These officials observe that these assets are always used by the individual. The requested State would obtain and provide information relating to the bank account in the requested State of the individual in response to a specific request by the requesting State under Article 26 of the Convention.

Id.

60. *Id.* Hypothetical 6 provides:

> An individual subject to the requesting State's income tax operates a business. Although the business functions primarily within the territory of the requesting State, it does have some international sales. The individual forms a bearer share corporation in a third country and confidentially maintains possession of all the shares. The corporation maintains a bank account in the requested State in the corporate name with the individual as the sole authorized signature authority. The business enters into a contract with the corporation under which the corporation agrees to perform "market research." No market research is performed. The business pays substantial fees for this service which are deposited into the bank account in the requested State. The business records the fees as expenses on the business books and records. As a result, business income is substantially reduced. Because the business books and records are used to prepare the individual's income tax return, his reported gross income, taxable income, and tax due are substantially understated. Specifically, the individual's income tax return, and the component to that return on which the individual reports business receipts, expenses, and other items related to the business, understates the gross business receipts and other income related entries.

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In the seventh example, the individual operates a cash only service, maintains two bank accounts (one for skimmed money and one for a corporation used to pay expenses), does not keep records, and an informant tells the authorities of these activities.[61]

> Tax officials of the requesting State randomly select the individual for a tax audit. When these officials observe that substantial payments were made to a foreign corporation and claimed as business expenses on the individual's tax return, these officials ask the individual whether he or someone else owns the foreign corporation. The individual denies any ownership interest in the foreign corporation and claims that it is owned by a third party who has actually conducted market research for the business. Tax officials of the requesting State then initiate an investigation of the individual. Subsequently, an ex-spouse tells these officials that the individual maintains a bank account in the requested State under the name of the foreign corporation and that the payments to the corporation for market research were deposited in this bank account.
>
> The requested State would obtain and provide information relating to the bank account in the requested State of the foreign corporation in response to a specific request by the requesting State under Article 26 of the Convention.

Id.

61. *Id.* Hypothetical 7 provides:

> An individual controls a corporation that is subject to the requesting State's income tax and that operates a business which provides a service on a "cash only" basis. The individual regularly skims a substantial portion of these cash receipts and deposits these skimmed receipts in a bank account in the requested State maintained in his own name. The remainder of the cash receipts is deposited in a bank account in the requesting State maintained in the corporation's name. The corporation pays its business expenses with checks drafted against this latter bank account. No record of business receipts or expenses is kept other than the bank account records in the requesting and requested State.
>
> A corporate income tax return is filed, understating gross income, taxable income, and tax due, to the extent of the skimmed business receipts. Specifically, the corporation's income tax return, on which the corporation reports gross receipts, cost of goods sold, dividends, compensation of officers, balance sheet information, and other items related to the corporation, understates gross receipts and other items mentioned above.
>
> An informant tells the tax officials of the requesting State about the corporate business, including the skimming activities, and the bank account in the requested State, specifically stating that the individual told him that he skimmed no less than 30 per cent of the gross receipts every week and deposited these skimmed receipts in an account under his name in the X Bank located in the requested State. Based on this information tax officials of the requesting State commence an investigation of the corporation and the individual for possible tax violations under the requesting State's law.

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In the eighth example, an individual is the chief executive officer ("CEO") of a public corporation, the corporation pays bribes to get new and maintain old contracts, and the CEO tells the accountants not to report this information and to destroy all records.[62]

In the ninth example, the individual is a tax shelter promoter in which the individual sells limited partnership interests in research and development companies and authorities conduct an investigation and determine that the individual was in fact selling tax shelters to other taxpayers.[63]

> The requested State would obtain and provide information relating to the bank account in the requested State of the individual in response to a specific request by the requesting State under Article 26 of the Convention.

Id.

62. *Id.* Hypothetical 8 provides:

> An individual subject to the requesting State's income tax is employed as the chief executive officer of a publicly held corporation of the requesting State that does subcontract work for other corporations of the requesting State. To ensure that the corporation keeps certain existing contracts and secures new ones, it pays bribes to employees of a major contractor. The funds from which the bribes are paid come from random diverted corporate gross receipts. The chief executive officer instructs the corporate accountant (1) not to report diverted receipts on the corporate books and records and (2) to destroy all documentation of those receipts held by the corporation. The books and records understating gross receipts are used to prepare the corporate income tax return, and, thus, the corporate income tax return understates the gross receipts and other income related entries. (The same books and records are used to prepare inaccurate income statements upon which shareholders and potential investors rely.)
>
> The chief executive officer deposits the diverted funds into a bank account in the requested State over which he has sole signature authority. He periodically authorizes payments from that account to other accounts at the same bank over which the respective bribe recipients have signature authority. Based on information, which includes all the details stated above, provided by a staff accountant that works for the corporate accountant, tax officials of the requesting State initiate an investigation of the chief executive officer and the corporate accountant for their role in assisting in the preparation of a false corporate income tax return, and the bribe recipients for omitting the bribe payments from their individual income tax returns.
>
> The requested State would obtain and provide information relating to the bank account in the requested State over which the chief executive officer has signature authority and the bank accounts in the requested State over which the respective bribe recipients have signature authority in response to a specific request by the requesting State under Article 26 of the Convention.

Id.

63. Treasury Announces Mutual Agreement with Switzerland Regarding Tax Information Exchange, *supra* note 4. Hypothetical 9 provides:

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In the tenth example, the individual is a tax shelter promoter who promotes a method for investors to get a deduction of four times greater than the amount of their investment. Here, authorities disallow these deductions and investigate the promoter for having told taxpayers that they could take the deductions.[64]

An individual subject to the requesting State's income tax is a tax shelter promoter. Several tax shelter partnerships in which he sells limited partnership interests involve research and development companies incorporated and ostensibly operating in the requested State. The prospectus issued to investors for each shelter offers "investment opportunities by providing highly leveraged tax deductions." The investment per limited partnership share required for each shelter is $50,000, which includes a cash payment of $10,000 and a promissory note for $40,000 due in 30 years with interest accrued and payable at the end of that period.

Tax officials of the requesting State initiate an investigation of the promoter to determine whether he aided and assisted in the preparation of false individual income tax returns filed by the investors, as well as whether the promoter failed to report the income he made from the promotion of the tax shelter on his individual income tax return. During the course of the investigation, these officials interview numerous investors in each shelter who claim the promoter stated that (1) the only payment ever required from an investor was the $10,000 and (2) the note was only for tax purposes and would never be collected. During audits of several investors, tax officials of the requesting State discover that all $10,000 payment checks were deposited to an identifiable bank account in the requested State.

The requested State would obtain and provide information relating to the bank account in the requested State into which the payment checks were deposited in response to a specific request by the requesting State under Article 26 of the Convention.

Id.

64. *Id.* Hypothetical 10 provides:

An individual subject to the requesting State's income tax is a tax shelter promoter. He promotes and sells a movie tax shelter in which a corporation of the requested State ostensibly intends to produce feature films for profit. Limited partnership shares in movies to be produced are sold to investors in the requesting State for $25,000 per share with assurances that deductions can be taken against income in the amounts of $100,000 per share (a leverage of 4 to 1). In fact, the corporation in the requested State is a shell and the movie shelter scheme is a fraud. All monies received in the scheme inure to the personal benefit of the promoter. Upon receipt of investors' $25,000 payments, the promoter deposits the funds into a bank account in the requested State over which he has sole signature authority. The promoter then prepares documentation based upon complete fabrication which he submits to the investors.

The investors, in reliance on such documentation, prepare and file false individual income tax returns claiming tax benefits derived from the movie shelter. Upon audit by the tax officials of the requesting State,

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In the eleventh example, an individual earns income by telling taxpayers to violate income tax laws. Authorities investigate this individual to determine if the individual told taxpayers to prepare false returns.[65]

In the twelfth hypothetical, an individual has a bank account in the requested state where the individual deposits income that is payable to the requested state and authorities conduct an investigation of the taxpayer based upon information provided from a credit card linked to this bank account.[66]

> these benefits are denied. A tax official of the requesting State initiates an investigation to determine whether the promoter aided and assisted in the preparation of the investors' false tax returns, as well as whether the promoter failed to report income made from the tax shelter promotion on his individual income tax return.
>
> The requested State would obtain and provide information relating to the bank account in the requested State over which the promoter has signature authority in response to a specific request by the requesting State under Article 26 of the Convention.

Id.

65. *Id.* Hypothetical 11 provides:

> An individual has income as a salaried employee and earns income by conducting promotional events in which he encourages taxpayers to violate the requesting State's tax laws. Although the individual is subject to the requesting State's income tax, he does not file a tax return. The individual earns income at the promotional events by selling pamphlets in which he illustrates methods of evading income tax that he knows to be unlawful but that he represents to attendees of his promotional events to be lawful. He sells numerous pamphlets, each for a significant price.
>
> Tax officials of the requesting State initiate an investigation of the individual to determine whether he aided and assisted in the preparation of the false individual income tax returns of those attending the promotional events, as well as willfully evaded his individual income taxes. These officials interview several promotional event attendees and purchasers of the pamphlets and discover that numerous checks in payment for the pamphlets were deposited into a bank account in the requested State.
>
> The requested State would obtain and provide information relating to the bank account in the requested State into which the checks for payment were deposited in response to a specific request by the requesting State under Article 26 of the Convention.

Id.

66. *Id.* Hypothetical 12 provides:

> An individual maintains a bank account in the requested State into which he deposits income that is subject to the income tax in the requesting State. He makes substantial withdrawals from this bank account, through the use of a credit card tied to such account and issued in the name of a corporation, to pay for his living expenses for the year. The individual does not file an income tax return.

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In the thirteenth example, an individual provides a cash only service, has two bank accounts (one in the requested state where the individual deposits skimmed money and the other in the requesting state where the individual deposits the remainder of funds in the company's name), and an informant tells authorities about what is taking place.[67]

> Tax officials of the requesting State commence an investigation of the individual based on information received from a credit card company related to credit cards tied to bank accounts in the requested State, and from various merchants. The tax officials determine that a credit card tied to a bank account in the requested State and issued in the name of a corporation was used throughout the year to purchase numerous personal items that were delivered to the individual. When these officials ask the individual whether he owns or controls the bank account, the individual does not acknowledge any interest in the corporation or the bank account, and provides no explanation regarding the source of the funds in the bank account. The requested State would obtain and provide information relating to the bank account in the requested State in response to a specific request by the requesting State under Article 26 of the Convention.

Id.

67. *Id.* Hypothetical 13 provides:

> An individual operates a business which provides a service on a "cash only" basis. He regularly deposits a substantial portion of these cash receipts in a bank account in the requested State maintained in his own name. He deposits the remainder of his cash receipts in a bank account in the requesting State maintained in his business name. He pays his business expenses by drafting checks against the latter bank account. He keeps no record of business receipts or expenses other than his bank account records in the requesting and requested State. Although the individual is subject to the requesting State's income tax, he does not file a return.
>
> An informant tells tax officials of the requesting State about the business, specifically stating that the individual told him that he deposited no less than 30 per cent of his gross receipts in an account under his name in the X Bank located in the requested State. The informant also tells tax officials of the requesting State that the individual has used proceeds from the bank account in the requested State to purchase assets, formal legal ownership of which has been placed in the names of other persons.
>
> Based on this information tax officials of the requesting State commence an investigation of the individual. Among other things, these officials learn that the individual used cash to buy particular assets, and has with documentation placed legal ownership to these assets in the name of other persons. These officials observe that these assets are always used by the individual.
>
> The requested State would obtain and provide information relating to the bank account in the requested State of the individual in response to a specific request by the requesting State under Article 26 of the Convention.

Id.

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The fourteenth and final hypothetical involves a situation where an individual has the individual's employer issue the individual's salary checks in the name of a corporation, the individual claims the individual is acting as an independent contractor, the individual does not file a tax return in the requesting state as required, and an informant tells the authorities.[68]

The U.S. viewed the expansion of the 1996 Agreement as critical to combating and catching tax fraud. While the Swiss were of the same frame of mind, they also viewed it as an opportunity to clean up the Swiss's reputation for being a haven for money laundering, organized crime and tax fraud.[69]

IV. WHAT AFFECT WILL THE NEW AGREEMENT HAVE

The 2003 Agreement has several important features that will have significant importance in the future. The most important feature though is, "to facilitate more effective tax information exchange between the two countries."[70] The Department of the Treasury Press Release stated:

> Acting U.S. Treasury Secretary Kenneth W. Dam and Swiss Finance Minister Kaspar Villiger exchanged letters today [Jan. 24, 2003] welcoming

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68. *Id.* Hypothetical 14 provides:

> An individual instructs his employer to make his salary checks payable to a corporation purporting to provide services as an independent contractor. The employer does not provide the documentation as required under the requesting State's tax law in the case of compensation provided to an employee. The individual opens a bank account in the X Bank located in the requested State in the name of that corporation, and deposits checks from his employer in that account. Although the individual is subject to the requesting State's income tax, he does not file a tax return.
>
> Based on information provided by an informant, tax officials of the requesting State initiate an investigation of the individual. The tax officials contact the individual's employer, and obtain cancelled salary checks payable to the corporation and deposited in the bank account in the X Bank located in the requested State.
>
> The requested State would obtain and provide information relating to the bank account in the requested State in the name of the corporation in response to a specific request by the requesting State under Article 26 of the Convention.

Id.

69. *See* Moser, *supra* note 39, at 322.

70. Treasury Announces Mutual Agreement with Switzerland Regarding Tax Information Exchange, *supra* note 4.

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> the agreement as important to the administration and enforcement of the tax laws of each country. The letters express the intent of the two countries to maintain a dialogue with a view to monitoring and improving the functioning of the current Income Tax Convention, in addition to explore [sic] other ways to improve cooperation between the two countries.[71]

The changes to the 1996 Agreement contained in the 2003 Agreement should significantly improve information sharing between the U.S. and Switzerland for several reasons. The 2003 Agreement provides an easing of Swiss banking secrecy laws with respect to tax fraud committed by U.S. persons.[72] In Switzerland, such a change will likely have a significant impact on how business is conducted within its borders with respect to U.S. taxpayers. This change has significant cultural import for the Swiss. "Swiss banking secrecy has protected victims of persecution for over three centuries. First created to protect Huguenots fleeing France, Swiss banking secrecy was maintained during World War II to protect the identity of refugees from Nazi persecution."[73] However, these long protected laws have more recently become somewhat of an embarrassment for the Swiss by assisting in earning the Swiss a reputation of being a haven for tax fraud, money laundering[74] and organized

71. *Id.*

72. *See* Cynthia Shelton, Marnin Michaels, Stephanie Jarrett, & Denis Bedroz, *Switzerland and U.S. Agree to Swap Tax Information*, 14 J. INT'L TAX'N 54 (Apr. 2003).

73. Moser, *supra* note 39, at 321 (citations omitted).

74. *Id.* at 327–29 (providing:

> According to Article 305, money laundering is a criminal act when the proceeds derive from any criminal activity. Money laundering internationally, involves at least three activities: "smuggling dirty money to a secret Swiss . . . bank account; . . . altering its nature and/or origin; . . . repatriating the 'newly clean' money and using it for investment, pleasure or in some cases bribery." However, in Switzerland the days of the direct transfer of suspect liquid funds are practically over. Money laundering activities in the 1990s more commonly encompasses pre-laundering of funds in off-shore markets before transferring the funds to Switzerland. However, evidence of such pre-laundering activities has also been discovered *within* Switzerland. In 1989, a parliamentary investigating committee found that several financial institutions knowingly involved themselves in pre-laundering activities.
>
> Pre-laundering activities typically involve "paper corporations" that are set up in countries like Liechtenstein, Panama, or other small offshore havens. Paper corporations make it more difficult for dirty money to be traced to suspect criminal activities. Swiss authorities are faced with that difficulty today that when paper corporations are used in

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crime.[75] One commentator stated:

> More recently, however, money laundering and organized crime have subverted this underlying, noble purpose of Swiss banking secrecy. In order to meet the challenge presented by the sheltering of criminal activity, Switzerland must reconsider its renowned commitment to absolute banking secrecy. An amendment to Article 305 of the Swiss Penal Code, recently adopted by the Swiss parliament, maintains the basic principle of banking secrecy while tailoring appropriate exceptions aimed at criminal banking activity. As a result, the new law appeases international pressure on Switzerland to relax its banking secrecy laws, eliminates conflicts currently existing in Swiss law concerning banking secrecy, and provides an increased deterrent to money laundering. However, success in curbing money laundering merely by its enactment is unlikely. The Swiss bankers' willingness to avail themselves of the new law will be the determinative factor.[76]

Therefore, the 2003 Agreement is seen by the Swiss as a means of clearing their name among the international community[77] by easing their banking secrecy laws and allowing for a greater sharing of information with other countries. A few years ago, this would have been unheard of for the Swiss.

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conjunction with a Swiss bank account, criminals are twice or thrice shielded. Criminal origins are obscured by transferring funds to "paper corporations," which in turn engage in financial transactions involving Swiss banks and other financial institutions. The Swiss Federal Council is acutely aware of the pre-laundering problem and other money laundering activities in Switzerland.).

75. *Id.* at 321; *see also id.* at 330 (citations omitted) (providing:

> A second abuse of Swiss banking secrecy is by organized crime. Organized crime problems, such as small-time crime organizations, "the turning plate of the service sector" and "the infiltration of the legal economy" were found to be especially troublesome in large financial districts such as Zurich, Geneva, and the Tessin. The Federal Council established that legislation is needed to address the infiltration. Since there are no statistics in Switzerland concerning cases of organized crime specifically, examples must be used instead. However, the total crime realized in Switzerland rose steadily from 310,930 cases in 1988 to 359,201 cases in 1991.).

76. *Id. at* 321.

77. *See id.* at 321–22.

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Kaspar Villiger of the Swiss Confederation stated that:

> I am very pleased with the report that the technical discussions held between representatives of the Federal Tax Administration and of the United States Treasury, respectively, regarding the application of Article 26 on Exchange of Information of the Income Tax Convention between the Swiss Confederation and the United States of America, signed on October 2, 1996, have led to the successful conclusion of a mutual agreement, signed on January 23, 2003. This arrangement is important to the administration and enforcement of the tax laws of each of our countries, and complements the substantial cooperation between our two countries to combat criminal activities in other fields such as money laundering and terrorism financing.
>
> It is important to build upon this success and we must maintain a dialogue with a view to monitoring and improving the functioning of the present version of the Convention. In addition we will continue to explore ways to improve the cooperation between our two countries. Successful renegotiation of the Convention could enhance the economic relationship between our two countries. We look forward to continuing to work together to improve the cooperation between our two countries.[78]

For the United States, the 2003 Agreement is considered significant because it expands the U.S.'s ability to increase its international surveillance of tax fraud and enables the U.S. to further monitor possible terrorists and their finances in the war against terrorism.[79] Reportedly, several terrorists use

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78. Treasury Announces Mutual Agreement with Switzerland Regarding Tax Information Exchange, *supra* note 4

79. After the September 11, 2001 attacks in New York city, President Bush made a promise to the world that he would wage a war against terrorists and terrorism, not only to protect the American people but also to protect the interest and safety of the international community. *See* Ari Fleischer, White House Briefing, FED. NEWS SERV. 1 (Dec. 5, 2001); John C. Henry, *U.S. Rejects ABM Treaty, Pushes Missile Defense,* HOUS. CHRON., Dec. 14, 2001, at A1; David E. Sanger, *A Nation Challenged: The World Economy; Entangle with War on Terror, Threat of Global Recession*, N.Y. TIMES, Nov. 1, 2001, at B6.

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Switzerland as a means of hiding their money from the U.S.[80] During one hearing on Capitol Hill, Steven Emerson testified on the activities of various terrorist related organizations stating:

> [N]on-profit organizations in the United States [were established] to raise money for the Jihad, under the pretext [sic] collecting money for 'needy families' and 'orphans.'
>
> . . . .
>
> Promotional materials distributed by the Islamic Fund for Palestine advised donors that: "The Islamic Fund for Palestine (IFP) is a charitable, non-profit institution. It works to collect donations, contributions, and all possible humanitarian aid in favor of the Palestinian people in the occupied home. It aims to support the steadfastness of that people in the face of different hardships, reduce its suffering, and provide emergency relief and basic living needs for the most harmed sector of that people." The advertisements listed bank accounts in the United States and Switzerland through which to donate funds.[81]

However, with the renewed effort at information sharing between Switzerland and the U.S. stemming from the 2003 Agreement, it will be harder for terrorists or persons wishing to commit tax fraud to conduct their business in Switzerland because the Swiss are now not so willing to protect these people from the wrath of the U.S. The U.S. Department of Treasury stated:

> Access to needed information is vital to our efforts to ensure full and fair enforcement of our tax laws," stated Treasury Assistant Secretary for Tax Policy Pamela Olson. "This Mutual Agreement should improve our access to needed information under the current bilateral tax treaty between the United

80. See, e.g., Progress Since 9/11: The Effectiveness of U.S. Anti-Terrorist Financing Efforts, Hearing Before the Subcommittee on Oversight and Investigations of the Committee on Financial Services U.S. House of Representatives, 108th Cong. 78, 79 (2003) (testimony of Steven Emerson, Executive Director, The Investigative Project) (stating that the Islamic Fund for Palestine, a charitable, non- profit institution, with ties to al-Qaeda, was established in the United States and used bank accounts in Switzerland to house donated funds).

81. *Id.*

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> States and Switzerland. We look forward to working with Switzerland to further improve this relationship. Treasury is committed to continuing its efforts to improve and expand the U.S.'s broad network of bilateral tax treaties and tax information exchange agreements," Olson added. "Better tax information exchange relationships will permit the IRS to obtain the information it needs from other countries so it can pursue taxpayers attempting to hide income offshore to avoid their tax obligations.[82]

Overall, the 2003 Agreement should be very successful, not only for the U.S. but Switzerland as well. The 2003 Agreement will serve several purposes. First, the 2003 Agreement will aid the U.S. and Switzerland in their efforts to combat tax fraud. Second, the 2003 Agreement will assist the U.S.'s effort to find the financial funding for terrorism and cut it off. Third, the 2003 Agreement will help abate Switzerland's reputation as a haven for money laundering and organized crime. As Acting Treasury Secretary Kenneth W. Dam stated:

> I am pleased that this Mutual Agreement on tax information exchange has been reached with Switzerland, a key financial center . . . this Mutual Agreement is a significant step in our efforts to ensure that no safe haven exists anywhere in the world for the funds associated with illicit activities, including tax evasion. I look forward to continuing progress with Switzerland and other financial centers in this important area.[83]

V. CONCLUSION

The 2003 Agreement is intended to promote information sharing between the U.S. and Switzerland where information is being gathered on persons who may have committed tax fraud or certain other acts.[84] The 2003 Agreement appears to cure the problems contained in the 1996 Agreement relating to information sharing and tax fraud.[85] As a result, the 2003

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82. Treasury Announces Mutual Agreement with Switzerland Regarding Tax Information Exchange, *supra* note 4.

83. *Id.*

84. Alison Bennett, *U.S., Switzerland Reach Mutual Agreement On Civil, Criminal Tax Information Exchange*, DAILY TAX REPORT, Jan. 27, 2003, at GG–1.

85. *Id.* (stating "[t]he document announces an understanding that Article 26 and

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Agreement should be successful in meeting the U.S.'s goal of gaining better access to certain information on U.S. taxpayers who are Swiss depositors. In addition, the 2003 Agreement will also likely allow the U.S. and Switzerland to achieve other objectives, such as improving Switzerland's reputation and helping the U.S. combat terrorism.

Paragraph 10 'will be interpreted to support the tax administration and enforcement efforts of each contracting state to the greatest extent possible.'").