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Swiss Court Enjoins Tax Administration From Providing Names of Bank Employees, Other Third Parties to IRS

In Decision 2C_640/2016, published on 3 January 2018, the Swiss Federal Supreme Court ("Court") addressed the issue of whether, in response to a request for information by the IRS under the exchange-of-information clause of the U.S.-Swiss double taxation treaty DTT),[1] the Swiss Tax Administration (STA) has to redact the names of bank employees and other third parties involved in the management of accounts a U.S. taxpayer maintained at Swiss banks that participated as category 2 banks in the U.S. Tax Program for Swiss Banks (U.S. Tax Program). The ability of the IRS to access information about bankers and other third parties has been the source of uncertainty and anxiety for many, particularly following recent press reports that the IRS had lodged information requests that no longer targeted U.S. taxpayers but bank employees and other third-party advisors.

In its decision, the Court provided far-reaching but not definitive guidance to the STA in relation to this important issue. The decision will also control the exchange of information with tax authorities in jurisdictions other than the U.S., which is relevant given the ongoing tax controversies between Switzerland and France as well as other jurisdictions.

The key points of the decision are as follows:

- The Court recalled that under the pertinent standards of information exchange in tax matters, requested information should be provided to the IRS whenever that information is probably relevant (*vraisemblablement pertinente*) for assessment of a U.S. taxpayer's tax obligation. This standard aligns with the "foreseeably relevant" standard under exchange-of-information agreements that track the OECD Model Treaty.
- The Court held that there may be situations where contributing acts of third parties, including bank employees, have a bearing on the assessment of a taxpayer's tax obligations, and, accordingly, information about them should be disclosed. However, the Court took the view that, as a rule, such assessment does not require information about the identity of such third parties.
- The Court reminded that a distinction must be made between the assessment and enforcement of tax obligations of taxpayers and the criminal prosecution of third parties, such as bank employees. Using pointed language, the court said that administrative assistance in tax matters must not be used for the wrong purposes (*des fins détournées*), that is the purpose of obtaining information about accomplices of a taxpayer that may be subject to criminal prosecution (if that information is not needed to clarify the tax situation of the U.S. taxpayer).
- The Court suggested that the identity of employees and third parties may be disclosable to the IRS, if the IRS requests such information specifically and if it is certain that the information is necessary (*données [de] caractère necessaire avéré*) for assessment of the U.S. taxpayer's tax obligation.

While on the face of its decision the Court kept the door ajar for the IRS to obtain information about employees and other third parties from the STA, we do not see any clearance between the door frame and the door leaf; we are of the view that, in practical terms, the door is closed. While the decision alleviates some of the concerns that bank employees and others have had, it is unfortunate that the Court

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did not seize the opportunity to provide for complete certainty in this regard.

From a broader perspective, the decision may be viewed as a further setback for the U.S. authorities and their efforts to pursue bankers and others that have been involved in the management of undeclared assets. In light of the relative tightness of the rules relating to legal assistance in criminal matters, it will be more challenging, but not impossible, for the DOJ to obtain information about third parties also going forward.

The Broader Context—The Saga Around Employee and Other Third-Party Data Unfolding

Dilemma between DOJ's request to cooperating banks to provide information about employees and other third parties and limitations under Swiss law. From the outset of the Swiss-U.S. tax controversy, the DOJ sought not only to prosecute U.S. taxpayers and the banks where they maintained their accounts. As illustrated by a substantial number of indictments over the years, the DOJ has also pursued third parties, such as bank employees, who were involved in the management of the assets, or lawyers and other service providers who helped taxpayers structure their wealth by way of transferring assets into offshore investment vehicles or other means.

The banks that cooperated with the DOJ found themselves between a rock and a hard place. On one side, the DOJ insisted that the banks disclose the names and other data on such third parties and, on the other side, the banks were bound by a number of Swiss laws that provided for limitations with respect to the disclosure of such data. Specifically, the banks have been bound by the Swiss Data Protection Act (DPA),[2] which imposes limitations on the disclosure of personal data to third parties as such (see DPA Articles 4 and 13) and more generally on the transfer of personal data abroad (see DPA Article 6). In addition, with respect to personal data relating to their employees, the banks must comply with their general obligation of care and duty to protect their employees' personal data under Swiss employment law.[3]

Some of the banks that had been under investigation early on, that is category 1 banks, had opted to disclose substantial amounts of information on their employees and other third parties in their efforts to cooperate with the DOJ. In doing so, they relied on Swiss data protection and employment law not providing an outright ban of the sharing of personal data but a balancing test.

Swiss Federal Data and Information Commissioner requests that employees, other third parties be able to object to disclosure of data in court. The disclosure of data about employees and other third parties became a significant political issue, which was eventually raised with the Federal Data Protection and Information Commissioner ("the Commissioner"). Following his involvement in 2012, the Commissioner soon issued guidance with respect to the disclosure of third-party data by cooperating banks, vis-á-vis, first, several category 1 banks and later all banks that intended to cooperate with the DOJ. In essence, the Commissioner requested that the banks pre-inform affected employees of their intent to share personal data with the DOJ to enable these employees to resort to the courts and have their objection to a bank's finding under the applicable balancing of interest test adjudicated in accordance with Article 15 DPA.[4]

Swiss government represents that Swiss law permits effective participation by Swiss banks in Swiss Bank Program, under which disclosure of employees and other third-party data was required. It was against this backdrop that the Swiss government represented in its 29 August 2013 joint statement with the DOJ announcing the Swiss Bank Program[5] that Swiss law would "permit effective participation by the Swiss banks on the terms set out in the Program." This put the Swiss banks participating in the Program in a delicate situation because they now were bound by a commitment to cooperate under the terms of the Program, including to provide the names of employees involved in the management of the accounts and other third parties, e.g., trustees and other fiduciaries, attorneys, accountants,[6] while they were also subject to the aforementioned guidance by the Commissioner officer—guidance that they could not ignore.

Swiss courts intervene and Swiss Federal Supreme Court sets insurmountable hurdle for provision of names to DOJ under the Program—at this time. It was only a matter of time before the Swiss courts became concerned with the issue as civil law suits were brought against cooperating banks to block the disclosure of employee and third-party data despite the banks' execution of non-prosecution agreements under the Program. The issue reached the Court eventually.[7] Interestingly, the lower courts and the Court took the view that the DOJ must have been aware that Swiss courts may, case by case, enjoin banks from providing required data. In any event, the bottom line of the decisions was that under DPA Article 6, disclosure of employee and third-party data to the DOJ under the Program requires a showing that non-delivery of the data would either (1) translate into the Swiss-U.S. controversy flaring up again and the reputation of Switzerland as a reliable deal partner being undermined; or (2) result in a breach determination by the DOJ, with the criminal prosecution of the bank following such determination posing a significant threat to the Swiss financial system and the Swiss economy.

STA has processed IRS requests for information in forthcoming manner, taking view that employee and other third-party information should not be redacted. All this while, the STA has been handling significant numbers of requests for information by the IRS under the exchange-of-information clause in the U.S.-Swiss DTT, and it has done so on an expedited

[1] SR 0.672.933.61, www.irs.gov/pub/irs-trty/swiss.pdf.

[2] SR 235.1, www.admin.ch/gov/en/start/federal-law/classified-compilation.html.

[3] Articles 328 and 328b, Swiss Federal Code of Obligations (CO), SR 220, www.admin.ch/gov/en/start/federal-law/classified-compilation.html.

[4] See guidance papers at www.edoeb.admin.ch/edoeb/de/home/datenschutz/handel-und-wirtschaft/finanzwesen/uebermittlung-von-bankmitarbeiterdaten.html. For information in English,www.edoeb.admin.ch/edoeb/en/home/documentation/ annual-reports/20th-annual-report-2012-2013/transfer-of-employee-data-to-the-us-authorities.html.

basis and in a forthcoming manner. For instance, with respect to information in the files that the banks were requested to produce, the STA took the view that the names and other data about employees and other third parties involved in the management of a given account should not be redacted. Such a forthcoming attitude was to be expected in light of the commitments in the Joint Statement by the Swiss Federal Department of Finance, of which the STA is an administrative unit.

According to recent press reports, the STA has not changed its attitude even as the IRS started to submit requests that did not target taxpayers, but employees and other third parties. This resulted in a situation where the DOJ potentially could not obtain employee information under the Swiss Bank Program and yet the IRS continued to obtain that very same information from the STA via the administrative assistance route.

The Decision—No More Employee and Third-Party Data to IRS

Employees, other third parties have right to appeal STA decisions. Before bank employees and other third parties could effectively resort to the courts, they had to overcome the STA view that they did not even have a right to appeal its decision to provide their personal data to the IRS. Relying on the restrictive use proviso in Article 26 of the U.S.-Swiss DTT, the STA argued that the information can be used only to assess the taxes of the bank's former client, not against bank employees or other third parties that have been involved in the management of undeclared assets but that are themselves not subject to U.S. tax. In a recent decision, the Court deconstructed the STA's position quite elegantly and said that it was not possible for the STA to argue at the same time that the information was "necessary for carrying out the provision of the [DTT]" under the exchange-of-information clause in Article 26 of the DTT—that is, the assessment of U.S. taxes—and that the bank employee was not "specifically affected" by its decision within the meaning of Article 48 of the Swiss Federal Act on Administrative Procedure (providing the requirements for parties to have standing to appeal in administrative proceedings) because he was not subject to U.S. taxes.[8]

Scope of information to be provided under U.S.-Swiss DTT and exchange-of-information agreements that track the OECD Model Treaty as well as under Swiss Federal Act on Administrative Assistance in Tax Matters are aligned. In its most recent decision on the issue, which was provoked by an STA appeal against a decision by the Swiss Federal Administrative Court,[9] the Court first reminded that administrative assistance should be granted if there is a "reasonable suspicion" (*presumption raisonnable*) that an offence amounting to "tax fraud or the like" has been committed. The Court then examined the scope of documents covered by the exchange-of-information clause in Article 26 of the U.S.-Swiss DTT. In pertinent parts, the clause reads as follows:

> The competent authorities...shall exchange such information...as is necessary for carrying out the provisions of the...Convention or for the prevention of tax fraud or the like in relation to the taxes which are the subject of the present Convention.

With respect to the meaning of "necessary," the Court recalled that the purpose of administrative assistance is to provide information that is of evidentiary value for a requesting state's efforts to enforce its tax laws, and suggested on that ground that the requirement of "necessity" also entails the concept of "proportionality." In plain terms, although it is for the requesting state ultimately to form a view about the evidentiary value of data, the requested state must not provide documents of which it can be said with certainty that they have no bearing on the tax case that the requesting state pursues (*documents dont il apparait avec certitude qu'ils ne sont pas déterminants*).

As this same concept of "proportionality" is entailed in the "foreseeably relevant" standard under the exchange-of-information clause of the OECD Model Treaty, the Court concluded that its case law on requests for information under treaties with other countries that track the OECD Model Treaty also controls the construction of the "necessary" standard under the U.S.-Swiss DTT. The same is true, the Court held, with respect to the "foreseeably relevant" standard in Article 4(3) of the Swiss Federal Act on Administrative Assistance in Tax Matters.

Documents, including third party name, can be provided to requesting state if third party's i.d. is "foreseeably relevant" to elucidate taxpayer's tax position. The Court gave several examples where, in its view, the names of third parties should be provided because that information is in fact "foreseeably relevant" for assessment of the taxpayer's tax obligations. For instance, when the taxpayer's habitual residence was at issue, it could not be excluded with certainty that the identities of transaction counterparties did have a bearing on the tax situation.[10] Or the Court refers to cases in which it found that the identity of individuals with a power of attorney over an account should be disclosed.[11] In another case, the Court ordered disclosure of the identity of the directors of an offshore company, as this information was relevant to whether that company was a shell, which, in turn, may have had tax implications.[12]

I.d. of bank employees, other third parties who may have instigated, aided and abetted client in evading taxes has no bearing on taxpayer's tax obligation so that i.d. must not be disclosed. In the cases that the Court cited to provide color with respect to the proposition that the names of third parties may be fore-

5 Program for Non-Prosecution Agreements or Non-Target Letters for Swiss Banks, www.justice.gov.

6 see Swiss Bank Program, II.D.1.b. and II.D.2.b.v.

7 See Decisions 4A_83/2016 and 4A_73/2017.

8 APA, SR 172.02; see also Article 19(2) Swiss Federal Act on International Administrative Assistance in Tax Matters (SR 651.1), which refers to Article 48 APA; both at www.admin.ch/opc/en/classified-compilation/19680294/index.html; Decision 2C_792/2016.

9 Decisions A 5149/2015, A-5150/2015.

10 Decision 2C_1174/2014.

11 Decisions 2C_963/2014 and 2A.430/2005.

12 Decision 2C_904/2015.

seeably relevant and disclosable, the Court always ordered that the names of bank employees be redacted. In fact, the Court cited a more recent case where it held that, as a rule, the identity of bank employees has no bearing on the underlying issue of a bank's client.[13] This is not to say that the Court ignores that the involvement of third parties, including bank employees, could be relevant for the assessment of tax liabilities. The Court concedes that it may matter whether the taxpayer evaded taxes on his own motion or was instigated by a bank employee who may have wanted to obtain new business, or whether a bank employee together with other third parties assisted in the setup of tax-avoidance structures. While such acts by accomplices may be "foreseeably relevant," the Court concluded apodictically, however, that this is not so with respect to the identity of these accomplices (*ce qui est toutefois necessaire sous cet angles est l'information relative á l'existence et á l'intervention de ces tiers, et non pas á leur identité*).

Information about i.d. of bank employees, third parties must be obtained from banks under Program. With respect to the potential criminal prosecution of such third-party accomplices, the Court made it clear that the administrative assistance channel via tax authorities must not be conflated with the separate channels through which legal assistance in criminal matters can be sought. Using pointed language, the Court posited that administrative assistance in tax matters must not be used for the wrong purposes (*des fins détournées*), that is, the purpose of obtaining information about accomplices of a taxpayer that may be subject to criminal prosecution. Instead, the court refers the U.S. authorities to the Swiss Bank Program as the proper avenue to obtain information about bank employees and other third parties involved in a U.S. account.

This proposition comes across somewhat ironically following the court's earlier decisions that lifted the bar for banks to provide that information to virtually insurmountable levels. It would have been more appropriate, in our view, to remind the U.S. authorities of the legal assistance channel that is available in criminal matters (see below).

Quo Vadimus—Remaining Channel(s) for U.S. Authorities to Obtain Employee, Third-Party Data

Court left door ajar but we do not see any clearance between door frame and door leaf to get through it. The Court rendered the decision in relation to a request by which the IRS did not target bank employees or third parties; the disclosure of their identity would have "simply" been a by-product of the exchange of relevant information about the taxpayer's account. With this in mind, the Court made a reservation with respect to situations in which the requesting state requests information about bank employees and third parties specifically. While this leaves the door ajar, we do not believe that there is room for the IRS to get through it, for two reasons.

First, the Court appears to introduce a novel and very high standard for the disclosure of such data. It did not refrain from referring to a standard or refer to the known "foreseeably relevant" standard. Instead, the court suggested that such data can be disclosed only if it is certain that it is necessary (*données [de] caractère necessaire avéré*). The Court did not provide explicitly for a reference point of such necessity—the assessment of a taxpayer's tax obligations one would assume—and it is unclear what was the driver for the Court to use this language; it was not necessary for the Court to go there and the language does not seem to have any legal basis. It comes across as an afterthought that the Court may not have considered fully.

Second, the Court made it clear in its reasoning, as set out above, that a distinction must be made between the administrative assistance channel available in tax matters via the STA and the channel for legal assistance in criminal matters, which is to be used for purposes of prosecuting accomplices of taxpayers. The purpose of the legal assistance channel is for the IRS to obtain information necessary to assess federal income taxes and excise taxes on certain insurance premiums as well as any identical or substantially similar taxes. The Court would ignore its own differentiation if in a future case it would indeed allow the IRS to target accomplices and obtain information for purposes of prosecuting them.

Legal Assistance in Criminal Matters

While the court did refer the U.S. authorities specifically to the Swiss Bank Program only and not the Swiss-U.S. Treaty for Mutual Legal Assistance in Criminal Matters[14] or the Swiss Federal Act on Mutual Legal Assistance in Criminal Matters,[15] we are of the view that these are the only channels of inter-governmental information exchange that continue to be available to U.S. authorities (DOJ) to obtain information about bank employees and other third parties. While the MLAT is extremely restrictive in relation to legal assistance for tax offences, the DOJ is able to rely on the somewhat more permissive International Mutual Assistance in Criminal Matters (IMAC), which allows for assistance in cases of "aggravated tax fraud" as defined in Article 14(2) of the Swiss Federal Act on Criminal Administrative Law (SR 313.0). Under this provision, information can be obtained when a person evades taxes by using false, forged, or untrue information, or engages in activities that qualify as a "scheme of lies," which may include use of offshore shell companies. Although we are not aware of any controlling case law, we would not exclude the possibility, depending on the specific circumstances, that legal assistance is being granted and information exchanged when there are sufficient indications that a bank employee or a third-party advisor has actively aided and abetted a U.S. client in his criminal tax-evasion activities. ●

[13] Decision 2C_1174/2014.

[14] MLAT, 0.351.933.6, www.rhf.admin.ch/dam/data/rhf/strafrecht/rechtsgrundlagen/sr-0-351-933-6-e.pdf.

[15] SR 351.1, www.admin.ch/opc/en/classified-compilation/19810037/index.html.