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Hong Kong and Singapore: Awaiting a New DOJ Tax Program for Asian Banks?

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As the Department of Justice is wrapping up its prosecution of over a dozen Swiss banks, federal prosecutors and IRS special agents are analyzing a treasure trove of previously undeclared taxpayer account information that nearly 80 Swiss banks (Category 2 banks) have provided to the Department pursuant to the DOJ's Program for Non-Prosecution Agreements or Non-Target Letters for Swiss Banks. Armed with this information, the DOJ and IRS are currently tracing funds and accounts that left Swiss banks and reached other financial institutions in Singapore and Hong Kong to avoid detection by U.S. authorities.

As offshore tax enforcement remains a top priority for the Department of Justice, the DOJ Tax Division and the IRS are actively reviewing account information obtained from Category 2 banks and using it to identify and investigate U.S. account holders who concealed their foreign accounts and potentially evaded U.S. tax, as well as the foreign entities and individuals who assisted them. The consequences of the initiation of prosecution alone can be dire for targeted financial institutions in Singapore and Hong Kong, and could lead to the seizure of U.S. correspondent bank accounts, the suspension of the ability to conduct transactions using the U.S. financial system and the arrest and extradition of staff, among other things.

Riding the (Swiss) Wave of Success

After pursuing Swiss banks for allegedly harboring untaxed American assets for several years, on August 29, 2013, the Department of Justice announced a Program for Non-Prosecution Agreements or Non-Target Letters for Swiss Banks (the Program). Under the Program, many Swiss banks, most of which the Department had little or no information about, came forward and admitted to engaging in certain conduct that may have violated U.S. tax laws. These financial institutions, identified by the Program as Category 2 banks, were required to make a complete disclosure of the potential misconduct, provide detailed information regarding U.S.-related accounts, cooperate in treaty requests, provide detailed information

about other financial institutions that transferred funds into their accounts or that accepted funds when Swiss bank accounts were closed, and agree to cooperate in related criminal and civil proceedings.

In addition, pursuant to the Program, each Category 2 bank was obligated to pay penalties based on the value of their U.S.-related accounts, which could have been reduced if the bank was able to establish, to the Department's satisfaction, that a U.S.-related account was not undeclared, was reported by the bank to the IRS or the Department of Treasury, or that the bank had successfully persuaded the accountholder to participate in one of the IRS voluntary disclosure programs, such as the Offshore Voluntary Disclosure Program (OVDP) or the IRS Streamlined Disclosure Program. Category 2 banks that satisfied these requirements and agreed to the proposed penalties were eligible for non-prosecution agreements.

Pursuant to the Program, between March 2015 and January 2016, the Department entered into 78 non-prosecution agreements with nearly 80 Swiss banks, collecting more than \$1.3 billion in penalties, receiving a trove of information regarding accounts related to U.S. taxpayers, and ensuring the cooperation of participating banks in the Department's ongoing effort to prosecute offshore tax evasion.

While the conclusion of the Program's non-prosecution agreements was a major milestone for the Department, it certainly did not represent the end of the Program. Indeed, as offshore tax enforcement remains a top priority for the Department, the DOJ Tax Division and the IRS are actively reviewing account information obtained from Category 2 banks and using it to identify and investigate U.S. accountholders who concealed their foreign accounts and potentially evaded U.S. tax, as well as those entities and individuals that assisted them.

Following the Money ... to Asia

As a result of numerous leads received from various sources, including tax whistleblowers, responses to treaty requests, cooperators, and Leaver List information that the Department has collected from Category 2 banks, the DOJ and IRS have aggressively and successfully pursued foreign entities and individuals that assisted U.S. taxpayers in concealing their assets.

As recently announced by Caroline Ciruolo, the DOJ Tax Division's acting assistant attorney general, the Department is currently pursuing investigations of foreign financial institutions located in offshore jurisdictions that were referenced in the various statements of facts provided by Category 2 banks in connection with their non-prosecution agreements. Indeed, armed with detailed information that Category 2 banks have provided to the DOJ about other financial institutions that accepted funds when Swiss accounts were closed (the Leaver Lists), the DOJ and IRS are currently tracing funds and accounts that have emigrated from Swiss banks in the midst of the Program and reached other financial institutions in Singapore and Hong Kong to avoid detection by U.S. authorities.¹

The DOJ's focus on Asian banks, however, should not come as a surprise. Indeed, as Hong Kong and Singapore financial institutions are generally estimated to manage over \$1 trillion in assets, they present a particularly suitable pool for potential U.S. tax and criminal enforcement actions. Furthermore, in addition to being identified by many Leaver Lists submitted by Category 2 banks pursuant to the Program, Hong Kong and Singapore banks have previously been recognized as potential targets of investigations by U.S. authorities because of their countries' perceived secrecy and what the Department views as a lack of

¹ For instance, the IRS recently issued an administrative summons, followed by a DOJ summons enforcement action, to the Singapore office of a large financial institution seeking records related to an accountholder who had transferred funds from Switzerland to Singapore while the Department was investigating Swiss financial institutions for their alleged role in aiding American taxpayers evade U.S. taxes.

strong internal compliance programs that, according to DOJ, affects many of the region's financial institutions.

Implications for Hong Kong and Singapore Financial Institutions

Singapore and Hong Kong banks and asset management firms that may have accepted Swiss bank "leavers" over the past years should consider the potential implications that an Asia-focused DOJ pursuit of offshore tax evasion may have on their operations and, perhaps more importantly, their reputation and ability to conduct business with their counterparts within the US financial industry.

Indeed, while it has now been rumored for years that a Swiss-like DOJ tax program may be in the works, the Department has recently confirmed that Asia-based entities that assisted U.S. accountholders to conceal foreign accounts and potentially evade U.S. tax will not improve their situation by delaying disclosure in the hope of an announcement of another program, particularly as the Department and the IRS are actively reviewing information received by Category 2 banks and starting additional criminal investigations in the region.

Therefore, Hong Kong and Singapore financial institutions that may have received potentially high risk funds from Swiss accounts should take immediate steps to determine the scope of their potential exposure to U.S. criminal tax liability and devise an effective and comprehensive forward-looking remediation and mitigation strategy. In particular, among other things, these institutions should:

- Identify Swiss-source funds and potentially high risk "leaver" accounts;
- Identify current and former employees, along with any third-party, responsible for onboarding Swiss bank "leavers";
- Retrieve and preserve onboarding documentation and Know Your Customer (KYC) materials related to Swiss-originated "leavers," including relevant materials not in the bank's possession or overseas;
- Assess and potentially remediate high risk "leaver" accounts; and
- Implement robust tax, KYC and anti-money laundering compliance programs, as appropriate, along with related internal controls and employee trainings.

As the Department is opening additional criminal tax investigations around the world including in many Asian countries, and as evidenced by the Department's latest enforcement actions and announcements, inaction is no longer an option.

If you have any questions about the content of this Alert, please contact the Pillsbury attorney with whom you regularly work, or the attorneys below.

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