

# International Tax Developments

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*By Eva Farkas-DiNardo and Edward Tanenbaum*

## Treasury's Investigation of U.S. Clients of Swiss Banks

**T**he U.S. Justice Department and the U.S. Treasury Department ("the Treasury") have increased their efforts to uncover U.S. taxpayers who are allegedly evading U.S. taxes by hiding assets in Switzerland. Switzerland has strict bank secrecy laws and a finding of tax fraud is required before any information is released about bank clients.

### Requesting and Obtaining Information

A federal judge issued a John Doe summons on July 1, 2008, requiring UBS to provide bank records and account information identifying U.S. taxpayers who may have used Swiss bank accounts to avoid paying U.S. income taxes between 2002 and 2007. The U.S. authorities did not provide a list of names and, instead, requested information on U.S. account holders as a class. As a result, the U.S. government allegedly obtained the names of 70 U.S. taxpayer clients of UBS in November 2008, although it is not clear from whom they obtained these names. The United States has been looking to receive the names of approximately 19,000 U.S. clients of the bank, as estimated in a U.S. Senate report released in July 2008.

The release of information relating to U.S. clients surprised many, due to Switzerland's strict bank secrecy laws. However, these laws do not protect those who committed tax fraud, which is a crime under Swiss law. Tax evasion (as defined under Swiss law), on the other hand, is not considered a crime under Swiss law.

The U.S. and Switzerland have an agreement pursuant to which the U.S. government can request the assistance of the Swiss government in connection with alleged tax fraud committed by U.S. taxpayers. Once the U.S. government makes such a request, the Swiss tax authorities conduct their own investigation into the alleged tax fraud cases and provide information to the U.S. government if they determine as a result of their investigation that tax fraud has occurred.

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## **Legal Action by U.S. Clients Against Release of Information**

A number of U.S. citizens with bank accounts at UBS are reportedly in the process of taking legal action in Switzerland in order to prevent the Swiss tax authorities from turning over the clients' bank account information to the U.S. authorities.

The U.S. citizens planning legal action are not among the 70 individuals whose names have allegedly already been released to the U.S. authorities. In any event, the number of names that ultimately will be released by the Swiss authorities or by the bank may remain low as Swiss internal investigators recently determined that criminal tax fraud, as defined under Swiss law, occurs in only a small number of cases involving U.S. account holders.

Meanwhile, it has also been reported that the U.S. government has expanded its investigation into the cross border banking activities of both Credit Suisse and HSBC.

Most recently, the United States and Liechtenstein reported that they have signed an Information Exchange Agreement to become effective January 1, 2010. The agreement looks to be slightly stronger in favor of the United States than the agreement between the United States and Switzerland.

## **Advanced Notice of Proposed Rulemaking Under Code Sec. 897**

The IRS and the Treasury filed an advanced notice of proposed rulemaking with the Federal Register on October 30, 2008 (Announcement 2008-115), addressing the applicability of the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) to certain permits, licenses, franchises or similar rights granted by the U.S. government that are related to the lease, ownership or use of toll roads, toll bridges and other physical infrastructures. These proposed rules would amend Reg. §1.897-1 (Taxation of foreign investment in United States real property interests [USRPI], definition of terms).

Under current rules, a USRPI includes any interest in real property located in the United States or the Virgin Islands and any interest (other than solely as a creditor)

in a domestic corporation that is a U.S. real property holding corporation (USRPHC). Real property includes land, unsevered natural products of the land, improvements (including buildings and any other inherently permanent structure) and personal property associated with the use of real property. An interest in real property includes fee ownership, co-ownership, leaseholds, options to acquire land or leaseholds and any right to share in the appreciation in the value or the gross or net proceeds or profits generated by real property.

Under these current rules—in transactions, for example, where a domestic partnership with domestic corporations as partners (with foreign persons as the ultimate shareholders)

leases infrastructure assets (e.g., a toll road or toll bridge) in the United States and also acquires the required governmental licenses, permits or similar rights—the IRS says that it is aware that taxpayers take the position that, for purposes of Code Sec. 897, governmental permits, licenses or similar rights are not USRPIs, but assets used or held for use in a trade or business. Not treating governmental permits, licenses or similar rights as USRPIs would affect the determination of whether a corporation is a USRPHC for purposes of Code Sec. 897.

The proposed regulations would provide rules regarding the definition of an interest in real property, and addressing licenses, permits, franchises or other similar rights granted by a governmental unit that are related to the value of the use or ownership of an interest in real property. The proposed regulations would provide guidance on how the fair market value of such licenses, permits or franchises would be taken into account when determining the fair market value of a corporation's USRPIs. If these rights are treated as USRPIs, pursuant to Code Sec. 897(a)(1), the gain or loss of a foreign person arising from the disposition of such a USRPI is treated as if the foreign person were engaged in a trade or business in the United States, and as if the gain or loss were effectively connected with such trade or business in the United States.

The IRS has requested comments on the scope of the proposed rules and the allocation of the consideration paid for these rights for purposes of determining the fair market value of such property, and for the purpose of determining the fair market values of a corporation's real property interests.

Once the U.S. government makes such a request, the Swiss tax authorities conduct their own investigation into the alleged tax fraud cases and provide information to the U.S. government if they determine as a result of their investigation that tax fraud has occurred.