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Practice Update

Has the IRS Found the Next Swiss Bank Program?

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In late 2024, the IRS, through the Department of Justice, filed a series of *ex parte* John Doe Summons enforcement proceedings against a series of entities thought to have records with respect to U.S. taxpayers potentially engaging in offshore tax planning — or, as the IRS put it, tax evasion.[1] This large-scale effort is reminiscent of the Swiss Bank Program, which led to consequences not only for a number of participating Swiss foreign financial institutions, but also their customers. In fact, some of the cases currently being litigated *still* have origins or connection to Swiss financial institutions that were part of the original Swiss Bank Program, suggesting that any noncompliance found as a result of these John Doe Summonses could trigger years — if not decades — of litigation and compliance efforts by the IRS.

The Swiss Bank Program refers to a joint effort by the DOJ and the IRS to target offshore tax planning and tax noncompliance, including delinquent foreign financial asset reporting. The various investigations led to the DOJ pursuing criminal charges against certain Swiss banks, employees of Swiss banks, and U.S. taxpayers who used the services of the Swiss banks, and also a compliance

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program overseen by the DOJ whereby the Swiss banks could resolve potential criminal liabilities through a non-prosecution agreement (NPA). In order to be eligible for an NPA, a Swiss bank had to satisfy certain requirements. These requirements generally included: (1) paying penalties/fines to be eligible to participate; (2) providing detailed information about U.S. taxpayers; and (3) cooperating with treaty requests and disclosures.

As a result of the Swiss Bank Program, a number of individual U.S. taxpayers experienced audits leading to income tax and foreign information reporting consequences (namely FinCEN Forms 114 (FBARs) and Forms 8938 (Statement of Specified Foreign Financial Assets)), including penalties, from the influx of information the IRS obtained through these NPAs. Given that the Swiss banks also turned over internal records, correspondence, and coded notes regarding or with U.S. taxpayers, like various other foreign financial institutions often do, the IRS and DOJ pursued criminal charges against certain U.S. taxpayers, too. If this is any indication of what is to come from the recent John Doe Summonses, U.S. taxpayers who used the services of the foreign financial institutions named in the Summonses should consider taking a hard look at their tax planning and related activity, including ownership of foreign accounts and foreign entities (including trusts and corporations), to determine whether any noncompliance (inadvertent or otherwise) needs to be rectified. Rectifying those efforts as soon as possible is critical, because certain defenses and/or the ability to participate in voluntary disclosure programs often become unavailable once the IRS starts its own investigation.

And, given that these recently issued Summonses seem geared to target the users of the offshore services — not necessarily the providers of those services — the U.S. taxpayers who participated may see IRS inquiries sooner rather than later. This may be because the IRS seems more focused on one particular provider of services at this point, and so there very well may be consequences for the provider at some point as well.

What Is a John Doe Summons?

A "John Doe Summons" is an *ex parte* petition filed by the government pursuant to Section 7609(f). It is a special type of summons for two reasons. First, it is generally used to gather information about unidentified taxpayers who engaged in certain transactions or are suspected to have violated tax laws, such as those involved in offshore tax planning (and more recently, cryptocurrency transactions and/or Malta pension plan transactions). Second, it is the sole type of summons where the only pleadings considered by the court are those filed by the government. In other words, the court makes its decision on whether to enforce the summons based only on the factual allegations and/or corresponding law submitted by the government.

What Can the IRS Do With Information Obtained in Response to a John Doe Summons?

The IRS has very few legal restrictions on what it can do with the information obtained in response to a John Doe Summons. However, what the IRS actually *will* do with the information is another story. As the pleadings in these recent cases emphasize, the IRS will glean information about offshore activity from all sources, including the voluntary disclosure programs. The Revenue Agent's declaration made it clear that the IRS's Offshore Compliance Initiative noticed a pattern of taxpayers using the same service provider, which may have led, at least in part, to these enforcement proceedings.

At a minimum, taxpayers can expect that a group of IRS agents or the Offshore Compliance Initiative will likely review the information and refer individuals and/or entities for audit. These audits are expected to focus on actual or deemed amounts of unreported foreign income and U.S. international tax and information reporting obligations, including, but not limited to, failure to file FBARs, Forms 8938 for specified foreign financial assets, and/or any of the series of foreign entity "international information returns," such as Forms 5471 for foreign corporations, Forms 8621 for passive foreign investment companies (PFICs), Forms 8858 for foreign disregarded entities or branches, and/or Forms 3520 and Forms 3520-A for foreign trusts.

The complex issues associated with these types of investment arrangements described in the summonses, to name a few, may require determining ownership of foreign assets, valuations of the foreign assets, accrued income amounts, deemed income amounts, adjusted tax basis, and/or the entity classification of underlying foreign assets held in any foreign accounts, or held separately. Those issues are sure to result in time-consuming, nerve-wracking, and potentially financially devastating results. Not to mention that any of those compliance failures bring the added consequence of interest and penalties on unpaid taxes dating back to the initial year of reporting and even larger penalties related to each delinquent information return because of the unlimited assessment period from the open statute under Section 6501(c)(8).

How Can the IRS Penalize Taxpayers for not Disclosing These Foreign Accounts or Assets?

Non-Willful Penalties

In a normal case — that is, where the IRS considers the actions taken by noncompliant U.S. taxpayers "non-willful" — standard civil penalties apply and generally include a $10,000 penalty for each FBAR (adjusted by inflation) and/or each international information return per year, with the exception of certain forms related to foreign trusts and/or the contribution of property to certain foreign corporations. In those cases, the penalty can increase considerably. Underreporting of income is generally subject to a penalty capped at 25 percent.

For example, let's picture that in 2018, Alex, a U.S. citizen, creates a wholly owned foreign trust and a wholly owned foreign corporation, either directly or through a foreign financial custodian, and contributes $500,000 to the foreign trust and $500,000 to the foreign corporation. The foreign trust then creates and holds a foreign securities account that invests in certain foreign mutual funds, and the foreign corporation creates and holds a foreign deposit account. In 2019, (i) Alex receives a $100,000 distribution from the foreign trust, and (ii) the foreign corporation earns $100,000 in undistributed gains (i.e., Subpart F income) subject to tax at the highest individual rate of 37 percent (i.e., $37,000 of taxes) in 2019 and each year after.

Without addressing the complex U.S. tax rules behind each international information return reporting obligation, let's assume Alex, in addition to paying annual taxes on any income, was also required to file (i) Form 3520 for the contribution to, and U.S. ownership of, the foreign trust, (ii) Form 3520-A as a deemed U.S. owner of the foreign trust under the relevant grantor trust rules, (iii) Form 5471 for his ownership of the foreign corporation, (iv) Form 8621 for the indirect ownership of the foreign funds, (v) FBAR for his indirect ownership or "indirect financial interest" in the foreign accounts held by the foreign trust and foreign corporation, (vi) Form 8938 for his interest in the foreign trust and foreign corporation, and (vii) Form 926 for the transfer of cash to the foreign corporation. If Alex failed to file these forms or report the income each year from 2018 through 2024, the *non-willful* penalties and compounded interest could total almost $2 million.

Willful Penalties

In a case where the IRS considers the actions taken by noncompliant U.S. taxpayers to be "willful" or "fraudulent," civil penalties significantly increase. For example, the penalties for each required but unfiled FBAR increases to $100,000 or 50 percent of the account balance, whichever is greater, and the underreporting of income is generally subject to a penalty capped at 75 percent for the civil fraud penalty for the portion of the underpayment of tax that is attributable to fraud.

Criminal Penalties

In a case where the IRS considers the taxpayers' actions as criminally willful, the penalties for required but unfiled FBARs increase to between $250,000 and $500,000 and/or 5 to 10 years of imprisonment, depending on the severity of criminal conduct or enterprise. More significantly, the IRS may also try to use the information to build a "promoter case" against the service providers or consider criminal charges against individual U.S. taxpayers and/or service providers should the information reveal more egregious or systemic tax avoidance or evasion efforts.

For example, several tax evasion cases arose from the Swiss Bank Program. Following a 2011 indictment, two client advisors from the bank at issue pleaded guilty in 2016 "to conspiring with U.S. taxpayer clients and others to help U.S. taxpayers hide their assets in offshore accounts and to evade U.S. taxes on the income earned in those accounts."

Banks, employees, and even U.S. taxpayers could have criminal exposure depending on the severity of the tax failures. For example, in May 2024, a grand jury indicted a husband and wife in a tax evasion scheme that included criminal counts for the willful violation of FBAR reporting for assets held in offshore accounts. The husband's noncompliance began as early as 2008, which predated the Swiss Bank Program, but was one of the tax years for which the government received information from the Swiss banks in that program. This continued noncompliance sparked additional interest by the Senate Finance Committee, which has its own investigatory powers, suggesting that U.S. taxpayers who have information turned over to the IRS as a result of the Summonses could potentially be subject to years of investigations by different parts of the government.

Why Is a John Doe Summons so Effective?

Under the Foreign Account Tax Compliance Act (FATCA) or other intergovernmental information sharing methods — *i.e.*, pursuant to a treaty or Tax Information Exchange Agreements — the government has already identified the taxpayer, or taxpayers, whose information they are seeking. In contrast, a John Doe Summons is how the government learns the identity of taxpayers involved with a specific service provider or whose records are being held by the summonsed party. The summons can be enforced by a court and subject the summonsed party to contempt proceedings should they not comply. Once the IRS has information from the Summonses, it can then use other tools like FATCA to obtain and investigate data about any other foreign assets from other foreign financial institutions, too. If the IRS determines that the U.S. taxpayer is noncompliant, or purposefully withheld that information, all bets are off; that is, it could start an audit, apply automatic non-willful civil penalties, or, worse, pursue willful penalties or build a criminal case.

What Should Taxpayers Do Now?

Burying one's head in the sand — even on a warm island — is not advisable given the IRS's enforcement power. The government's recent summonses (which continue years-long enforcement initiatives of the IRS into offshore noncompliance) are a stark reminder to do a routine checkup of your (or your clients') offshore activity. Something as simple as inheriting cash in a bank account from a deceased foreign relative could trigger a reporting obligation. But, more importantly, these enforcement actions signal a focus on offshore entities — corporations, trusts, foundations (which are generally treated as foreign trusts) — and the obligations of U.S. taxpayers to report ownership in, activity of, or income from those entities (and potentially all three).

Therefore, similar to the Swiss Bank Program in 2008, U.S. taxpayers involved with any of the named service providers in the John Doe Summons (or similar service providers) should immediately (i) take good faith steps to ascertain past and ongoing U.S. tax liability and reporting requirements, (ii) consider whether they are eligible for the disclosure programs, civil or criminal, currently offered by the IRS, and (iii) if so, advance rectifying the failure to report those foreign accounts, entities, and/or income amounts as soon as possible including, hiring competent and experienced advisors to correct noncompliance as soon as possible. Otherwise, an unlimited statute of limitations applies and certain defenses or mitigation of penalties disappear.

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[1] *In the Matter of the Tax Liabilities of John Does*, Case No. 4:24-mc-127-RAL (D.S.D.); *In the Matter of the Tax Liabilities of John Does*, Case No. 1:24-mi-00126-SEG-RDC (N.D.Ga.); *In the Matter of the Tax Liabilities of John Does*, Case No. 1:24-mc-00594-JPC (S.D.N.Y.).
