

Credit Suisse's Impact On Its U.S. Clients

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In the government's criminal investigation and charging of Credit Suisse AG with helping U.S. taxpayers evade taxes, the IRS used a new and little-known provision of the code, section 6201(a)(4), to ensure that the Swiss bank paid \$666.5 million in restitution to the Service. This article examines the effect of the IRS's restitution-based assessment on the bank's U.S. clients. The authors also discuss issues specific to clients who have not reported or paid tax on foreign-source income, or submitted required information returns, such as Financial Crimes Enforcement Network Form 114, "Report of Foreign Bank and Financial Accounts."

On May 19 Credit Suisse AG agreed to plead guilty to a one count information that charged it with conspiracy against the United States to aid and assist in the preparation and presentation of false income tax returns and other documents for the IRS in violation of code section 7206(2).¹ The plea agreement culminates an almost four-year criminal investigation of Credit Suisse, a global Swiss bank founded in 1856, and its private banking and wealth services. The Swiss bank offered those services to its U.S. clients, which in turn concealed their Swiss accounts from the U.S. government.

In its 14-page plea agreement, Credit Suisse agrees to a restitution order for the full amount — \$666.5 million — of the victim's losses, to be paid within one week of sentencing. The agreement identifies the IRS as a victim that suffered losses.

The agreement contains special language providing that a relatively new provision of the code, section 6201(a)(4), is applicable to Credit Suisse's restitution order. That provision grants the IRS the

authority to assess and collect the restitution owed by Credit Suisse as if the amount were a tax. What does that language mean, and how does it affect Credit Suisse and its U.S. clients who apparently failed to report and pay tax on income from their undisclosed Swiss bank accounts?

This article addresses the following procedural questions raised by the Credit Suisse case:

1. Why did the IRS include a reference to section 6201(a)(4) in Credit Suisse's plea agreement, and what effect does it have on the bank and its U.S. clients?
2. Can the IRS assess restitution against Credit Suisse even though the unpaid income tax liabilities relate to its U.S. clients and not the bank?
3. What is the effect of the restitution payment on Credit Suisse's clients who may have failed to pay taxes to the IRS?
4. What is the effect, if any, of Credit Suisse's plea agreement on the statute of limitations for assessing taxes against its U.S. clients?

Background

Federal income tax and reporting laws apply to foreign financial accounts. U.S. citizens, lawful permanent residents, and individuals who have passed the substantial presence test² must:

- report and pay tax on income earned from foreign bank accounts;
- report on Schedule B of Form 1040, "U.S. Individual Income Tax Return," whether at any time during the year the person had a financial interest in or signature authority over a financial account (such as a bank, securities, or brokerage account) located in a foreign country, and identify the foreign country where the financial account is located; and

¹See *United States v. Credit Suisse AG*, 1:14-cr-188-RBS (E.D. Va.).

²The income tax and reporting obligations apply to U.S. persons, including (1) a citizen or resident of the United States, (2) a domestic partnership or corporation, (3) any estate (other than a foreign estate), and (4) any trust formed under the laws of the United States. Section 7701(a)(30). An alien (a non-U.S. citizen) is treated as a resident of the United States if the individual (1) is a lawful permanent resident of the United States at any time during the calendar year, (2) meets the substantial presence test, or (3) makes an election to be treated as a resident. Section 7701(b)(1)(A).

- file Financial Crimes Enforcement Network Form 114, “Report of Foreign Bank and Financial Accounts (FBAR),” formerly T.D. F 90-22.1, to report a financial interest in or signature authority over one or more financial accounts in a foreign country with an aggregate value of more than \$10,000 at any time during a particular year.³

It’s a federal crime for a bank to conspire with others to commit any offense — including aiding in the preparation of false or fraudulent tax returns⁴ — against the United States.⁵

Despite those laws, Credit Suisse helped U.S. clients open and maintain undeclared accounts and conceal offshore assets and income from the IRS.⁶ Swiss law permits Swiss banks to hide account ownership information, which contributed to Credit Suisse soliciting U.S. clients whom it aided in filing false and fraudulent tax returns.⁷

Credit Suisse helped clients conceal their offshore accounts by:

- assisting them in using sham entities as nominee beneficial owners of the undeclared accounts;
- soliciting IRS forms that falsely stated that the sham entities beneficially owned the assets in the accounts;
- failing to maintain in the United States records on the accounts; and
- facilitating the withdrawal of funds by providing hand-delivered cash in the United States or by using correspondent bank accounts in the United States.⁸

Credit Suisse serviced undeclared accounts for U.S. clients at offices in Zurich and Geneva.⁹ It used an office in New York to assist U.S. clients in filing false and fraudulent tax returns.¹⁰ Credit Suisse managers regularly traveled to the United States to meet with U.S. clients, and they communicated with those clients from Switzerland via telephone, fax, and mail.¹¹ U.S. clients filed false and fraudulent tax returns that failed to report their interests in their Credit Suisse accounts, and some of them did not file foreign bank account reports for those accounts.¹² Credit Suisse assisted U.S. clients in

accessing their offshore funds by providing credit or debit cards linked to their Credit Suisse accounts.¹³

Despite Credit Suisse’s bustling global banking business operating in more than 50 countries with about 22,000 U.S. client accounts,¹⁴ things began to change for the bank. In 2008 the United States increased enforcement efforts on undisclosed foreign financial accounts, and the Justice Department began a criminal tax investigation of UBS, another Swiss bank. In July 2008 UBS announced that it would no longer provide banking services to U.S. clients through its non-U.S. regulated entities.¹⁵ Soon after that, Credit Suisse took steps to exit its cross-border business with U.S. clients.¹⁶ Still, about two years later, in December 2010, the Justice Department Tax Division informed Credit Suisse that it had opened a criminal investigation on it.¹⁷

In May Credit Suisse entered into a plea agreement¹⁸ in which the bank agreed to a restitution order by the U.S. District Court for the Eastern District of Virginia for the full amount of the victim’s losses.¹⁹ The agreement identifies the IRS as at least one of the bank’s victims. The agreement states that Credit Suisse will pay restitution in the amount of \$666.5 million directly to the IRS under payment instructions provided to Credit Suisse.²⁰ The agreement provides the following additional language:

If the Court orders the defendant [Credit Suisse] to pay restitution to the IRS for the failure to pay tax, either directly or as part of the sentence or as a condition of supervised release, the IRS will use the restitution order as a basis for a civil assessment. See 26 U.S.C. 6201(a)(4).²¹

Tax practitioners have questioned whether section 6201(a)(4) applies to the restitution owed by Credit Suisse because it is not the taxpayer. The bank’s clients — and not Credit Suisse — were obligated to report and pay tax on the income from the undeclared accounts in Switzerland. How can the United States require Credit Suisse to pay the IRS restitution?

³31 U.S.C. section 5314; 31 CFR section 1010.350.

⁴Section 7206.

⁵18 U.S.C. section 371.

⁶Statement of Facts, at para. 9, filed in *United States v. Credit Suisse AG*, Criminal No. 1:14-cr-188-RBS.

⁷Id.

⁸Id.

⁹Id. at paras. 10-11.

¹⁰Id. at para. 12.

¹¹Id. at para. 17.

¹²Id. at para. 20.

¹³Id. at para. 34.

¹⁴Id. at para. 11.

¹⁵Id. at para. 56.

¹⁶Id. at paras. 54-63.

¹⁷Id. at para. 67.

¹⁸Plea Agreement, filed in *United States v. Credit Suisse AG*, Criminal No. 1:14-cr-188-RBS.

¹⁹Id. at para. 5.

²⁰Id.

²¹Id.

Section 6201(a)(4)

Section 6201(a)(4) applies to Credit Suisse. To understand why, we must first understand criminal restitution orders in federal district court. A federal district court, when sentencing a defendant convicted of some criminal offenses, may order it to make restitution to any victim of those offenses.²² It may also order restitution in a criminal case to the extent agreed to by the parties in a plea agreement.²³

As shown above, in criminal tax cases, the IRS may be identified as a victim. In those instances, the federal district court may order the defendant to pay restitution to the IRS for a tax-related loss.²⁴ Examples of tax-related losses include losses stemming from income underreporting, inflated credits or expenses, and alleged overpayments that result in false refunds.²⁵

Before 2010, neither Title 18 nor Title 26 gave the IRS the power to collect on a restitution order because restitution is not a tax.²⁶ Only the Justice Department had the power to collect criminal restitution.²⁷ Thus, even if a federal district court ordered a defendant to pay restitution to the IRS, it had no administrative means of collecting the restitution if the defendant didn't deliver.

In 2010 Congress expanded the IRS's collection authority. The Firearms Excise Tax Improvement Act of 2010 (FETIA) gave the IRS the power to collect unpaid restitution.²⁸ Section 3 of FETIA amended section 6201(a) by adding section 6201(a)(4). That section gives the IRS the authority to assess and collect restitution via an order under 35 U.S.C. section 3556 of Title 18 as if the amount were a tax. The IRS may not assess the restitution until all appeals of the restitution order are concluded and the right to make appeals has expired.²⁹ The amount of any restitution-based assessment may not be challenged based on the existence or amount of the underlying tax liability in any proceeding authorized under the code, including in any refund suit or proceeding under section 7422.³⁰

Congress made two more changes to the code when it enacted FETIA. Section 6213(b)(5) provides that the restrictions applicable to deficiencies do not apply to assessments under section 6201(a)(4). In other words, a defendant does not have the right to

file a petition in Tax Court to challenge the IRS's assessment of the restitution. Section 6501(c)(11) provides that the general three-year limitation on the assessment of taxes does not apply to orders of restitution under section 6201(a)(4). That means the IRS may assess restitution at any time.

The question for practitioners is under what facts and circumstances does the IRS have the authority to make a restitution-based assessment against a defendant under section 6201(a)(4). The answer turns on whether the restitution is traceable to a tax imposed by Title 26. As explained by the IRS:

Restitution ordered for a criminal violation of IRC 7201 (attempt to evade or defeat tax), IRC 7202 (willful failure to collect or pay over tax), IRC 7203 (willful failure to file return), [or] IRC 7206(1) (fraud and false statements), as well as several other criminal tax violations under the Internal Revenue Code and Title 18 may meet the requirements necessary to be assessed as a tax.³¹

In short, section 6201(a)(4) provides a procedural mechanism for the IRS to collect restitution owed by a defendant in a criminal tax case.

Section 6201(a)(4) in the Plea Agreement

The fifth paragraph of the plea agreement references section 6201(a)(4). Thus, there is no question of the IRS's authority to collect the restitution due from Credit Suisse should it fail to pay. That section is effective for any restitution ordered after August 16, 2010. It clearly applies to Credit Suisse's restitution in this case.

In the plea agreement, Credit Suisse also agreed "to the entry of a Restitution Order for the full amount of the victim's losses."³² That language is important because section 6201(a)(4) requires an order under 18 U.S.C. section 3556 of Title 18. A restitution order from the federal district court in the Credit Suisse case is an order under that section.

Credit Suisse further agreed that:

If the Court orders the defendant to pay restitution to the IRS for failure to pay tax, either directly as part of the sentence or as a condition of supervised release, the IRS will use the restitution order as the basis for a civil assessment.³³

The IRS has the authority to make a restitution-based assessment only "for failure to pay any tax imposed under this title."³⁴ Once the federal district court enters a restitution order, the IRS has the

²²18 U.S.C. section 3556.

²³18 U.S.C. section 3663(a)(3).

²⁴CC-2011-018.

²⁵*Id.* at Q&A 2.

²⁶*Id.*

²⁷18 U.S.C. section 3612(c).

²⁸P.L. 111-237, section 3.

²⁹Section 6201(a)(4)(B).

³⁰Section 6201(a)(4)(C).

³¹CC-2011-018, Q&A 2.

³²Plea Agreement, *supra* note 18, at para. 5.

³³*Id.*

³⁴Section 6201(a)(4)(A).

power to assess the restitution. After that, it can use its administrative collection remedies under Title 26 to collect the amount of the unpaid restitution-based assessment directly against Credit Suisse.

In sum, section 6201(a)(4) gives the IRS the ability to collect the restitution should Credit Suisse fail to pay it.

The IRS's Ability to Assess Credit Suisse

The taxpayers in this case are the U.S. clients of Credit Suisse. They are the ones who failed to report and pay tax on income earned in their undisclosed Swiss bank accounts. How can the IRS assess restitution against the third-party Credit Suisse? The answer has to do with the language of section 6201(a)(4). It applies to the restitution here because it does not require that the defendant, who is ordered to pay the restitution, be the taxpayer. Section 6201(a)(4)(A) provides:

The Secretary shall assess and collect the amount of restitution *under an order pursuant to section 3556 of title 18, United States Code*, for failure to pay any tax imposed under this title in the same manner as if such amount were such tax. [Emphasis added.]

All that is required is an order from a federal district court mandating that a defendant pay restitution to the IRS. Once the order is in place against Credit Suisse, the IRS has the authority to make a restitution-based assessment against it, even though it's not the taxpayer.

The IRS Office of Chief Counsel has recognized that a restitution assessment may be made against a defendant who is not the taxpayer. CC-2013-012 explains:

The distinction between criminal restitution and tax liability is perhaps most starkly presented when a return preparer convicted of aiding and assisting in the preparation of the false returns, in violation of 26 U.S.C. section 7206(2), is ordered to pay restitution calculated with reference to the tax owed by his clients, a tax for which the return preparer is not civilly liable.

Similarly, CC-2011-018 states:

Question 4: Courts sometimes order an individual criminal defendant to pay the unpaid income tax liabilities and employment tax liabilities of a business entity as restitution. Can these liabilities be assessed against the individual criminal defendant?

Answer 4: Yes, provided the restitution ordered is determined to be assessable as described in Answer 2, above. Accordingly, the Service may assess any restitution ordered payable by a criminal defendant, even if the

restitution relates to the unpaid income or employment tax liabilities of the corresponding business entity or employer. In these cases, the Service must adjust the unpaid tax liability of the corresponding business entity or employer to account for any payments made through restitution or the restitution-based assessment against the criminal defendant. Likewise, the Service must adjust the unpaid restitution-based assessment liability of the criminal defendant to account for any payments made by or on behalf of the business entity or employer.

As long as the restitution that Credit Suisse pays is for the tax owed by its U.S. clients, the IRS has the authority to make a restitution-based assessment against the bank to collect any unpaid restitution. While the plea agreement does not say how the United States calculated the restitution amount, it presumably is for taxes owed by the bank's U.S. clients on their undisclosed Credit Suisse accounts.

Effects on Credit Suisse's Clients

Whether Credit Suisse's U.S. clients receive a credit for the restitution paid to the IRS depends on the language in the plea agreement defining why the bank paid restitution and the amount.

Restitution is meant to compensate the victim for losses proximately caused by the defendant's criminal conduct.³⁵ It is meant to make the victim whole, and not to result in its double recovery. Still, restitution ordered under a plea agreement may be, "to the extent agreed to by the parties in a plea agreement," for an amount greater or less than the loss attributable to the criminal offense.³⁶

Based on Credit Suisse's plea agreement and statement of facts, its restitution is for the unpaid taxes of U.S. clients that failed to report income earned on their Credit Suisse accounts.

As to whether the U.S. clients may receive a credit, CC-2013-012 states:

Any payments made to satisfy the restitution-based assessment must also be applied by the Service to satisfy the civil tax liability for the same tax period. The proper application of payments is achieved through the use of a mirrored assessment of restitution order and ultimate civil liability for the same period.

Similarly, the Eighth Circuit in *United States v. Tucker*, 217 F.3d 960 at 962 (8th Cir. 2000), says that "any amounts paid to the IRS as restitution must be deducted from any civil judgment [the] IRS obtains to collect the same tax deficiency." The Court of

³⁵*Paroline v. United States*, 134 S. Ct. 1710, 1720 (2014).

³⁶18 U.S.C. section 3663A(a)(3).

Appeals for the Second Circuit in *United States v. Helmsley*, 941 F.2d 71, 102 (2d Cir. 1991) echoes that reasoning:

We believe it is self-evident that any amount paid as restitution for taxes owed must be deducted from any judgment entered for unpaid taxes in such a civil proceeding. Restitution is in fact and law a payment of unpaid taxes.

The Internal Revenue Manual likewise provides:

For all return preparer project (RPP) cases, the amount of restitution is ordinarily based upon the erroneous tax refunds claimed by the clients of the return preparer. The amount of restitution may be calculated by using a specific group of clients and/or an additional amount computed by extrapolating the pattern of erroneous tax refunds to the total population of the preparer's clients. Therefore, in all RPP cases, the special agent must attach a list of all clients whose tax liability was used to determine the amount of restitution ordered by the court. The clients must be identified by name and social security number.³⁷

Because the IRS cannot collect both restitution and tax for the same liability, it should credit the restitution received from Credit Suisse against the tax liabilities of the bank's U.S. clients.

Period for Assessing Taxes Against U.S. Clients

The IRS may assess any tax imposed "within 3 years after the return was filed."³⁸ However, there are exceptions to that rule. For a false or fraudulent return with the intent to evade tax, the tax may be assessed at any time.³⁹

Several courts have held that the statute of limitations for assessment under section 6501(c)(1) can be extended even when the return was fraudulent because of the return preparer.⁴⁰ According to the Court of Appeals for the Second Circuit in *City Wide Transit*, 709 F.3d at 106-107, the only requirement to apply section 6501(c)(1) is for the IRS to establish a tax underpayment because of fraud. The Tax Court in *Allen*, 128 T.C. at 40, supported that kind of

extension, explaining that "an extended limitations period is warranted in the case of a false or fraudulent return because of the special disadvantage to the Commissioner in investigating these types of returns."

Credit Suisse pleaded guilty to violating section 7206(2). Its statement of facts states that its U.S. clients filed false and fraudulent income tax returns as a result of its actions.⁴¹ Those actions resulted in its U.S. clients underreporting their income and underpaying their taxes. Therefore, the U.S. government could argue that the limitations period for assessing taxes should be extended for Credit Suisse's U.S. clients.

State Tax Ramifications

Can anyone other than the IRS obtain restitution from Credit Suisse? Under the plea agreement, "victims of the conduct described in the charging instrument [or] statement of facts, or any related conduct" may seek restitution.⁴²

Many states with an income tax base the income subject to tax on federal adjusted gross income that is reported on federal returns. Thus, state tax agencies, such as the California Franchise Tax Board, the New York State Department of Taxation and Finance, and the Illinois Department of Revenue, could qualify as victims. To do so, they would need to present evidence supporting any claimed loss.

Clients of Credit Suisse against whom penalties may have been assessed for failure to report offshore income on their returns may be considered victims. Former clients' losses would be any penalties they are required to pay as a result of not reporting income from their Credit Suisse accounts. Still, those individuals would likely have a difficult time qualifying as victims and obtaining recovery.⁴³

Conclusion

The case against Credit Suisse illustrates how the IRS can use its administrative remedies under the code to ensure that the restitution amount due from such a bank is paid. The case highlights two other significant issues. First, the U.S. clients of Credit Suisse may be entitled to a credit against taxes owed to the IRS for the bank's restitution payment because of the legal theory behind restitution. Second, it's possible that the statute of limitations will

³⁷IRM section 25.26.1.3.1.2.C.

³⁸Section 6501(a).

³⁹Section 6501(c)(1).

⁴⁰*Allen v. Commissioner*, 128 T.C. 37 (2007) (limitations period for assessing taxes is extended if the taxes were understated because of fraud of the preparer); *City Wide Transit Inc. v. Commissioner*, 709 F.3d 102, 107 (2d Cir. 2013) (limitations period for assessing a taxpayer's liabilities is extended if they were understated because of fraud of the preparer); *Contra BASR Partnership v. United States*, 113 Fed. Cl. 181 (2013) (the fraud of the return preparer did not extend the statute of limitations on assessment).

⁴¹Statement of Facts, *supra* note 6, at para. 20.

⁴²Plea Agreement, *supra* note 18, at para. 5.

⁴³*United States v. Lazarenko*, 624 F.3d 1247, 1252 (9th Cir. 2010) ("As a general rule, an order of restitution to a co-conspirator is a 'fundamental' error that 'adversely reflect[s] on the public reputation of the judicial proceedings'"); 18 U.S.C. section 3663A(a)(2) ("the term 'victim' means a person directly and proximately harmed as a result of the commission of an offense for which restitution may be ordered").

not apply to the period that the IRS has to assess taxes due from the bank's U.S. clients because of the fraudulent spirit in which their returns were filed.

Those issues will play out as the IRS takes enforcement action against U.S. clients with undisclosed bank accounts at Credit Suisse and similarly situated banks around the world.

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