

COMMENTS

*Polemic in the
International Court of Justice*

*International Protection of
Computer Programs*

*Following in Another's Footsteps:
The Acquisition of International
Legal Standing by the
Palestine Liberation Organization*

*Some Aspects of Quebec's
Official Language Act*

*Bank Secrecy:
The End of an Era?*

BANK SECRECY: THE END OF AN ERA?

I. INTRODUCTION

Over the past decade legitimate businesses and organized crime have substantially increased their use of financial institutions¹ in order to circumvent various U. S. laws.² In 1969 the covert transfer of proceeds from narcotics trafficking, securities frauds, income tax evasion, S.E.E. margin violations and other illegal activities to secret foreign bank accounts constituted a significant portion of the U.S. balance of trade deficit.³ Congress responded to this problem by passing the Bank Secrecy Act of 1970⁴ which has recently been upheld as constitutional by the Supreme Court,⁵ and is considering the United States-Switzerland Treaty on Mutual Assistance in Criminal Matters.⁶ This Comment will examine the remedial effects of the Bank Secrecy Act and the Treaty by describing their approach to the problems inherent in the covert international transfer of funds, and by analyzing their impact on tax evasion, stock and securities frauds and organized crime.

II. THE BANK SECRECY ACT

With the passage of the Bank Secrecy Act and the accompanying Title III of Public Law 91-508,⁷ Congress took the first step in

1. Financial institutions include banks, brokerage houses, and companies and persons who engage in the currency business.

2. 2 U.S. CONG. AND ADMIN. NEWS 4395 (1970).

3. N.Y. Times, Feb. 26, 1970, at 38, col. 1. In 1969 the United States suffered a balance of payments deficit of seven billion dollars of which 3.2 billion were listed as errors and omissions. It was estimated that a major part of the latter total was due to criminal transfers of U.S. dollars into secret foreign bank accounts.

4. Bank Secrecy Act, 12 U.S.C. §1730d (1970), 12 U.S.C. §§1829b-31 (1970), 15 U.S.C. §78g (1970), 15 U.S.C. §1602 (1970), 15 U.S.C. §§1642-44 (1970), 15 U.S.C. §1681 (1970), 31 U.S.C. §§ 1051-62 (1970), 31 U.S.C. §§ 1101-22 (1970).

5. California Bankers Association v. Shultz, 416 U.S. 21 (1974). For a synopsis of this case see 2 SYR. J. INT'L L. & COM. 355 (1974).

6. Treaty between the United States of America and the Swiss Confederation on Mutual Assistance in Criminal Matters, 12 INT'L. LEG. MATS. 916 (1973) (hereinafter cited as Treaty). A copy is available from the U.S. Department of State, Washington, D.C. 20520. The Treaty is expected to be approved by the Congress and has been ratified by the Swiss Parliament. The Treaty becomes effective 180 days after both nations ratify it.

7. Bank Secrecy Act, 84 Stat. 1114, Pub. L. 91-508, was passed on October 26, 1970. It contains six titles. Titles I and II are known as "The Bank Secrecy Act;" Title III deals with the related problem of margin requirements and is an amendment to the Securities and Exchange Act of 1934, 15 U.S.C. § 78 (1934); Title IV deals with the effective date of the previous three titles by publication in the Federal Register; Title V consists of amendments

closing a "loophole" provided by secret foreign bank accounts.⁸ The first three Titles of Public Law 91-508 are intended to regulate five types of financial transactions:⁹ (1) U.S. banks and other financial institutions are required to maintain records of financial transactions and keep copies of checks pursuant to regulations issued by the Treasury Secretary;¹⁰ (2) financial institutions are required to report on currency deposits and withdrawals;¹¹ (3) persons who export or import currency in individual amounts greater than \$5,000 are required to file reports;¹² (4) the Secretary of the Treasury may require citizens who deal with foreign financial agencies to keep records of their transactions;¹³ and (5) the restrictions on purchasing securities on margin are expanded to include U.S. borrowers.¹⁴

A. *Financial Institution Recordkeeping*

Both chapters of Title I deal with financial recordkeeping. Under Chapter 1, the Treasury Secretary may require banks insured by the Federal Deposit Insurance Act (F.D.I.A.)¹⁵ to know the iden-

to the Truth in Lending Act, 15 U.S.C. § 1602 (1970); Title VI consists of amendments to the Consumer Credit Protection Act, 15 U.S.C. § 1601 (1970).

8. *Hearings on S.678 Before the Senate Subcommittee on Financial Institutions of the Committee on Banking and Commerce, 91st Congress, 1st and 2nd Sessions at 244-45 (1970)* (hereinafter cited as *Senate Subcommittee Hearings*), Statement by Robert Morgenthau:

Information and evidence developed in recent years shows that secret foreign accounts are used to conceal tax frauds, securities fraud, and many other types of criminal conduct ranging from the smuggling of heroin to payoffs to government employees. But in addition to those specific substantive violations, the availability of the secret foreign account to those with the resources to use it has created a loophole in our laws and in law enforcement. A democratic society such as ours depends on voluntary compliance. A gap available to some tends to discourage compliance on the part of the large majority otherwise willing to comply. Unless this loophole is closed, the honest business and professional man will be put to a great disadvantage and millions of other Americans will lose confidence that the laws of this country are being fairly and impartially enforced. We will not have fair and effective law enforcement in this country without a systematic and vigorous effort to bring all criminals including those who hold positions of responsibility and power in business and the financial world to the bar of justice.

9. S. REP. No. 91-1139, 91st Cong., 2d Sess. 1 (1970) (hereinafter cited as SENATE REPORT No. 91-1139).

10. Bank Secrecy Act, §101, 12 U.S.C. §§1829b-31 (1970), §§121-29, 12 U.S.C. §§1951-59 (1970). By making the chapter an amendment to the Federal Deposit Insurance Act, the recordkeeping requirements will be enforced by the various Federal examiners and supervisory agencies which enforce the F.D.I.A.

11. Bank Secrecy Act, §§221-23, 31 U.S.C. §§1081-83 (1970).

12. Bank Secrecy Act, §§231-35, 31 U.S.C. §§1101-05 (1970).

13. Bank Secrecy Act, §§241-42, 31 U.S.C. §§1121-22 (1970).

14. Bank Secrecy Act, §301(a), 15 U.S.C. §78g (1970).

15. Federal Deposit Insurance Act, 12 U.S.C. §§1811-31 (1970).

tity of each person authorized to make withdrawals, sign checks or act in any capacity regarding an account.¹⁶ In addition, the Secretary has the power to require that records be kept of any draft, check or other instrument presented for deposit or collection,¹⁷ and he may, at his discretion, require the maintenance of additional records not specified in the Act.¹⁸ Thus the Secretary is given wide latitude in determining what types of records are necessary to ensure that the congressional intent¹⁹ is fulfilled.

The recording requirements delineated in Chapter 1 are extended to all other financial institutions in Chapter 2.²⁰ The Secretary's authority to require recordkeeping also applies to any person, issuing or receiving checks or money orders in business,²¹ transferring funds or credits domestically,²² dealing in currencies or operating a currency exchange,²³ operating a credit card system²⁴ or engaging in any other similar activity specified by the Secretary.²⁵ Thus, almost every conceivable category of financial institution is within the Secretary's domain.

The Bank Secrecy Act also provides sanctions to be applied when its provisions are violated. The Treasury Secretary is empowered to seek injunctive relief, or to sue for civil or criminal penalties.²⁶ Pursuant to the power vested in him by the Act, the Treasury Secretary has issued regulations requiring every bank²⁷ and broker or dealer in stocks and securities²⁸ to secure, within 45 days from the date an account is opened, the taxpayer identification number of the individual opening the account. In the case of an account opened by one or more individuals, the financial institution must obtain the social security number of every individual having a financial interest in the account.²⁹ The regulations do provide, however,

16. Bank Secrecy Act, §101(c), 12 U.S.C. §1829b(c) (1970).

17. Bank Secrecy Act, §101(d), 12 U.S.C. §1829b(d) (1970).

18. Bank Secrecy Act, §101(f), 12 U.S.C. §1829b(f) (1970).

19. Bank Secrecy Act, §101(b), 12 U.S.C. §1829b(b) (1970).

20. Bank Secrecy Act, §123(a), 12 U.S.C. §1953a (1970).

21. Bank Secrecy Act, §123(b)(1), 12 U.S.C. §1953(b)(1) (1970).

22. Bank Secrecy Act, §123(b)(2), 12 U.S.C. §1953(b)(2) (1970).

23. Bank Secrecy Act, §123(b)(3), 12 U.S.C. §1953(b)(3) (1970).

24. Bank Secrecy Act, §123(b)(4), 12 U.S.C. §1953(b)(4) (1970).

25. Bank Secrecy Act, §123(b)(5), 12 U.S.C. §1953(b)(5) (1970).

26. Bank Secrecy Act, §§124-27, 12 U.S.C. §§1954-57 (1970).

27. 21 C.F.R. §103.11 (1974).

28. 31 C.F.R. §103.11 (1974).

29. 31 C.F.R. §103.11 (1974). The recording requirement for banks is found in §103.34(a), and the recording requirement for brokers and dealers in securities is found in §103.35(a).

for exceptions in certain instances.³⁰

Banks and brokers and dealers in securities are also required to microfilm, copy or reproduce and maintain copies of each document granting signature authority over any deposit or share account.³¹ In addition, all banks must keep records of all statements and of each check, draft or money order drawn on a bank when the amount is greater than \$100 and the account averages less than 100 checks per month.³² The Secretary has apparently decided that checks of less than \$100 pose no threat to the bank secrecy laws and that accounts with over 100 monthly checks are ordinary business accounts.³³ Banks must also keep records of all debits exceeding \$100 to a customer's account,³⁴ and moreover, banks are required to maintain records sufficient to reconstruct a demand account.³⁵ Financial institutions³⁶ must maintain separate records of each transfer greater than \$10,000 either into the United States from a foreign nation, or out of the United States.

The regulations accomplish two things: the identities of the account holders and other persons authorized to effect transactions in an account are now required to be recorded, and copies of the transactions are available if the need for them should arise. Access to these records, however, can only be obtained through a sub-

30. Among the exemptions the Secretary has granted are employees of a Maine bank who for 20 years have taken currency and checks in excess of \$5,000 across the Canadian border several times a month, and a company which transports sealed packages containing money and valuables under contract for banks, brokerage houses, and securities dealers. For a more complete list see the exemptions following 31 C.F.R. §103.51 (1970).

31. 31 C.F.R. §103.24(b)(1) (1970), for banks; 31 C.F.R. §103.35(b)(1) (1970), for brokers and dealers in securities.

32. 31 C.F.R. §103.34(b)(3) (1970).

33. Business accounts are subject to audit by the Internal Revenue Service — a practice which tends to discourage illegal transactions.

34. 31 C.F.R. §103.34(b)(4) (1970).

35. 31 C.F.R. §103.34(b)(10) (1970).

36. 31 C.F.R. §103.11(a) (1970) defines financial institution as:

Each agency, branch, or office within the United States of any person doing business in one or more of the capacities listed below:

- (1) A bank (except bank credit card systems);
- (2) A broker or dealer in securities;
- (3) A person who engages as a business in dealing in or exchanging currency as, for example, a dealer in foreign exchange or a person engaged primarily in the cashing of checks;
- (4) A person who engages as a business in the issuing, selling, or redeeming of travelers' checks, money orders, or similar instruments, except one who does so as a selling agent exclusively or as an incidental part of another business;
- (5) A licensed transmitter of funds; or other person engaged in the business of transmitting funds abroad for others.

poena.³⁷ While the regulations will encumber financial institutions with a great amount of paperwork, the need for these types of records outweighs the minimal cost and burden of keeping them.³⁸ The result is that any transaction which is conducted through a bank, and other significant transactions which are conducted through financial institutions, will be recorded. It will no longer be possible for a person to escape the documentation of his transactions by selecting a bank which does not maintain records.

B. Financial Institution Reporting

Although Chapter 2 of Title II implements this provision, Chapter 1 must first be examined because it contains several key definitions and provisions which are used throughout the Title. A "person" is defined in the Act to include: "all natural persons, partnerships, trusts, estates, associations, corporations, and all entities cognizable as legal personalities."³⁹ The Act defines "financial institution" in very broad terms, so that it includes everything from a bank to a pawnbroker.⁴⁰ The regulations, however, limited the term to include: banks, brokers or dealers in securities, currency exchanges, persons who engage in the regular business of transmitting funds abroad and those who deal in issuing, selling, or redeeming travelers' checks or money orders.⁴¹

Under Chapter 1 the Secretary is permitted to delegate his power to check compliance and he may, at his discretion, grant exemptions from the regulations.⁴² Thus, the Secretary may exempt firms engaged in legitimate businesses.⁴³ The provision for civil and criminal penalties for noncompliance and the right of the Secretary to sue for injunctive relief are similar to those enumerated in Title

37. 31 C.F.R. §103.51 (1970).

38. S. Rep. No. 91-1139, *supra* note 9, at 2-5. In 1970 the cost of microfilming checks ranged from $\frac{1}{2}$ to 1 $\frac{1}{2}$ mills per check. Banks usually charge 10 cents per check.

39. Bank Secrecy Act, §203(c), 31 U.S.C. §1052(c) (1970); 31 C.F.R. §103.11 (1974).

40. Bank Secrecy Act, §203(e), 31 U.S.C. §1052(e) (1970).

41. 31 C.F.R. §103.11(a) (1974). The Secretary did not include the following in his definition of "financial institution," although the Bank Secrecy Act authorized him to include them: telegraph companies; travel agencies; loan or finance companies; pawnbrokers; dealers in precious metals, stones or jewels; insurance companies; and operators of credit card systems.

42. Bank Secrecy Act, §205(a), 31 U.S.C. §1054(a) (1970); 31 C.F.R. §103.46 (1974). See also note 22 *supra*.

43. The problem with the exemption section is that most businesses appear to be legitimate at one time or another, even though some are not. Organized crime has been using the funds from foreign bank accounts to finance seemingly legitimate businesses. See note 163 *infra* and accompanying text.

I.⁴⁴ Chapter 1 does, however, specify an additional criminal penalty when the violation is in the furtherance of another federal crime or part of a specified activity.⁴⁵ This additional sanction is significant because Title II requires that certain physical currency transactions, not consummated within financial institutions, be reported to the Secretary.⁴⁶ The additional penalty is intended to serve as a deterrent against those who export funds in currency in order to escape the documentation of the transaction by banks and financial institutions. The Secretary has exercised his prerogative and issued regulations consistent with the maximum authority vested in him by the Act.⁴⁷

Chapter 1 also contains an immunity provision which compels a witness to testify before a court, a grand jury, or an agency of the United States after he has been granted immunity from criminal prosecution.⁴⁸ This immunity provision has not been incorporated into the regulations, however, so that any violator of the Act may not be compelled by the Act to testify.⁴⁹ This may be a significant omission by the Secretary, since violations of the Act will usually be part of an overall criminal scheme which directly involves violating the Act.⁵⁰ Finally, any information contained in the reports filed with the Secretary may be shared with other federal agencies investigating criminal, tax or other regulatory matters.⁵¹

Under Chapter 2 of Title II, which deals with domestic transactions,⁵² the Secretary may require any financial institution to report any transaction in U.S. currency or other monetary instruments.⁵³ The report must be signed by both the domestic financial institu-

44. Bank Secrecy Act, §207, 31 U.S.C. §1056 (1970), for civil penalty; §208, 31 U.S.C. §1057 (1970), for injunctions; §209, 31 U.S.C. §1058 (1970), for criminal penalty.

45. Bank Secrecy Act, §210, 31 U.S.C. §1059 (1970).

46. The recording provisions are complied with by financial institutions; the reporting by the senders and carriers. Because of this difference, the Government apparently felt that no additional penalty was needed to act as a deterrent against sending the currency as a physical entity.

47. This is one of the few times in the Bank Secrecy Act where he has done this.

48. Bank Secrecy Act, §211, 31 U.S.C. §1060 (1970). The immunity is for any testimony and all information obtained as a result of the testimony.

49. The immunity clause has not appeared in any of the regulations promulgated by the Secretary.

50. "Omission" perhaps is too kind a word. Since most, if not all, of the violations of the reporting requirements will be as part of another crime, the "omission" by the Secretary prevents the Government from using this valuable tool. However, there are other immunity provisions, *i.e.* in the organized crime area, which can be used, but only for those crimes.

51. Bank Secrecy Act, §212, 31 U.S.C. §1061 (1970); 31 C.F.R. §103.43 (1974).

52. Bank Secrecy Act, §221, 31 U.S.C. §1081 (1970).

53. Bank Secrecy Act, §§221-22, 31 U.S.C. §§1081-82 (1970).

tion and one or more of the participants in the transaction. If a participant is acting as the agent for another individual, he must identify the real party in interest.⁵⁴ The reports are to be filed with the Secretary or his designated institutions.⁵⁵

The Secretary's regulations require a report whenever a deposit, withdrawal, exchange of currency, or other payment or transfer greater than \$10,000 occurs through a financial institution.⁵⁶ The Secretary has exempted transactions involving Federal Reserve and Federal Home Loan Banks, in addition to transfers originated solely with or by financial institutions or foreign banks.⁵⁷ Thus, while these transactions will be recorded they will not be reported. Parties fearing only the reporting requirements could still effect transfers through these banks with small chance of incrimination.⁵⁸ Furthermore, if a bank has a customer whose business normally requires deposits and withdrawals in excess of \$10,000 and that customer has a normal depositor relationship with the bank, then the bank may, on its own initiative, not file reports with the Secretary.⁵⁹ The regulations do not define either "a business whose deposits or withdrawals normally require \$10,000 transactions" or a "normal depositor relationship." Thus, a bank, believing this type of an account exists, may be allowed to avoid the reporting requirement, and transactions which should have been reported will not be brought to the Secretary's attention. However, the bank will still have to record the transactions and these records would be available in the event of later criminal prosecutions.⁶⁰

This provision is significant because it requires that large withdrawals, deposits, or currency exchanges be reported to the Secre-

54. Bank Secrecy Act, §222, 31 U.S.C. §1082 (1970).

55. Bank Secrecy Act, §223, 31 U.S.C. §1083 (1970).

56. 31 C.F.R. §103.22(a) (1974).

57. 31 C.F.R. §103.22(b) (1974).

58. The parties' transactions in amounts of \$5,000 are only recorded and not reported unless in excess \$10,000. Furthermore, transactions of less than \$5,000 are only subject to a financial institution's own recording procedures.

59. 31 C.F.R. §103.22 (1974).

60. The banks will keep records of the depositors and give these records to the Secretary upon request. The Supreme Court recently decided *United States v. Biseglia*, 93 U.S. 1245 (1975), in which it ruled that the I.R.S. could go into banks and ask for the records of large numbers of depositors. This gives the I.R.S. the power to get records of depositors without knowing names and find out who has been avoiding taxes. This is similar to the Secretary getting reports of transactions, and allows the I.R.S. to get records which the Secretary would have to subpoena. The I.R.S. can get these groups of depositors' records without even naming the depositors individually.

tary, who may then investigate them if he deems it appropriate.⁶¹ In the case of smaller transactions and those which the banks have concluded are normal for an individual customer, the bank will still have to maintain the records required pursuant to Title I.⁶² Thus "the legislation significantly strengthens the hand of the Secretary in keeping track of large currency deposits or withdrawals."⁶³

C. Individual Reporting

Chapter 3 of Title II requires that a report be filed by any person who, acting as a principal, agent, or bailee, transports or causes to be transported, either into or out of the United States, a sum greater than \$5,000.⁶⁴ The report must state: the origin, destination, and route of the funds; the legal capacity of the filer with respect to the monetary instruments; and, in the event that the filer is not the legal or beneficial owner, nor the person in whose behalf the monetary instruments are being shipped, the report must specify either the sender or the recipient of the instruments.⁶⁵ In the event of noncompliance, the sender is subject to a \$1,000 fine and the funds may be forfeited.⁶⁶ Enforcement procedures stipulate that a search warrant must precede a search.⁶⁷

The regulations require that a report be filed by any person⁶⁸ who physically transports or mails a sum greater than \$5,000.⁶⁹ This regulation applies to transfers into the United States from a foreign nation, and vice-versa. This provision does not apply, however, to transfers of funds through normal banking channels, *i.e.*, when the funds themselves are not physically transferred.⁷⁰

It would be pointless for the Secretary to require financial institutions to maintain records and report certain transactions, while not taking measures to prevent the physical transfer of currency. This is especially true since many of the transfers might be made

61. This differs from records which the Secretary can see only after obtaining a subpoena. The reports will alert him to suspicious transactions.

62. See notes 16-38 *supra* and accompanying text.

63. The reports allow the Secretary to keep track of all large transfers of funds through the banks. The record-keeping requirement prevents transfers from going unrecorded.

64. Bank Secrecy Act, §231(a), 31 U.S.C. §1101(a) (1970).

65. Bank Secrecy Act, §231(b), 31 U.S.C. §1101(b) (1970).

66. Bank Secrecy Act, §232, 31 U.S.C. §1102 (1970). This is especially true since reports must be filed for transactions over \$5,000, which is greater than the \$1,000 fine.

67. Bank Secrecy Act, §235, 31 U.S.C. §1105 (1970).

68. 31 C.F.R. §103.11 (1974).

69. 31 C.F.R. §103.23(a)-(b) (1974).

70. 31 C.F.R. §103.23(c) (1974).

in order to avoid the recordkeeping and reporting of financial institutions. As physical transfers were not subject to documentation prior to the enactment of the Act, there developed an extensive courier system for transferring currency to foreign banks.⁷¹ The currency being transferred often comes from such illegal activities as gambling, loan sharking, income tax evasion, narcotics and prostitution.⁷²

If the required reports are filed, there would be no advantage to transferring the funds by courier, since the reports would serve as records and notify the Secretary of the forthcoming transaction. If the transaction were handled through normal banking channels, reports would not be filed unless the amount exceeded \$10,000.

Furthermore, the additional civil penalty, which allows the Government to keep the illegally transferred funds, should act as a deterrent since the confiscated funds will be greater than \$5,000. The effectiveness of this deterrent will be directly related, of course, to the Government's ability to prevent the illegal transfers.

The reporting requirement is also important because when an illegal transfer is intercepted, the Government will have an additional ground on which to prosecute.⁷³ Presumably, those persons seeking to avoid the reporting requirement will be attempting to avoid incrimination for illegal conduct. This provision would seem, therefore, to afford the Government an opportunity to prosecute an offender for violation of more than one crime. This is important, because those who presently transfer funds illegally will probably continue to do so, and a criminal conviction can now be obtained merely by proving that a report had not been filed.⁷⁴ Any original crime, of which the illegal transfer of funds was probably just a part, need not be proved, in order to obtain a conviction under this Title.

Although the immunity provision might have encouraged couriers to testify, this incentive was not included in the Secretary's regulations. Therefore, the Government might possibly use plea

71. S. REP. No. 91-1139, *supra* note 9, at 6. The couriers charge between two and five percent of the amount being carried.

72. *Id.*

73. The Government could prosecute for the crime itself and for the violation of the Bank Secrecy Act. For example, narcotics smugglers who do not report their cash transactions would be liable for the non-reporting under the Bank Secrecy Act in addition to the narcotics charges.

74. The crime which precipitated the violation of the Bank Secrecy Act does not need to be proved to send the alleged criminal to jail; conviction of violation of the Bank Secrecy Act will suffice.

bargaining in an attempt to influence the couriers to implicate the other parties to the transaction.

D. Individual Recordkeeping

Under Chapter 4 of Title II the Secretary might require businesses directly or indirectly engaged in foreign transactions to maintain records of their transactions. The records must include the identities of the parties to the transaction, the legal capacities of the parties to the transaction, the identities of the real parties in interest if one of the parties to the transaction is not a principal and a description of the transaction.⁷⁵ As was noted, the Secretary is empowered to exempt persons or groups from compliance with the provisions of this Chapter.⁷⁶ A subpoena is required to compel production of their records.⁷⁷

The regulations require all persons⁷⁸ to report, on their federal income tax return, any information regarding any financial interest, or any signature or other authority over a "bank, securities or other financial account in a foreign country."⁷⁹ Moreover, the regulations mandate that an individual maintain separate records of all information required on the tax return.⁸⁰ The records shall contain the number or other designation of each account, the name under which each account is maintained, the name and address of either the foreign bank or other person with whom the account is maintained and the type and maximum value of the account during the reporting period.⁸¹

The effectiveness of this provision will be dependent, of course, upon the ability of the Government to prohibit the unreported transfer of funds greater than \$5,000. If records of unreported transfers can be obtained, however, the Government will be supplied with invaluable aid in following their activities.⁸²

75. Bank Secrecy Act, §241(a), 31 U.S.C. §1121(a) (1970).

76. Bank Secrecy Act, §206, 31 U.S.C. §1055 (1970).

77. Bank Secrecy Act, §241(b), 31 U.S.C. §1121(b) (1970).

78. 31 C.F.R. §103.11 (1974).

79. 31 C.F.R. §103.24 (1974).

80. 31 C.F.R. §103.32 (1974).

81. 31 C.F.R. §103.32 (1974).

82. S. Rep. No. 91-1139, *supra* note 9, at 5. It will be difficult for the Government to enforce this part of the Act when consideration is given to the immense borders of the United States and the difficulty in preventing couriers from secretly crossing them.

E. Margin Requirements

While Title III is not officially part of the Bank Secrecy Act, it was enacted as part of Public Law 91-508.⁸³ It is necessary to examine Title III with the Act since it is intended to remedy some of the problems created by foreign bank secrecy. Title III, which amends the Securities Exchange Act of 1934,⁸⁴ makes it illegal for any person to receive a loan or credit which violates the margin requirements applicable to domestic lenders.⁸⁵

Under the regulations it is a violation of the Securities Act of 1934 for any borrower to receive more than the legally permissible margin.⁸⁶ The regulations stipulate that when the securities are used as the collateral the maximum margin which can be extended is 50 percent of the current market price. Thus, the borrower must put up 50 percent of the purchase price.⁸⁷ The regulation prevents borrowers from circumventing margin requirements which previously applied only to lenders.⁸⁸

Before Title III, American lenders had been disadvantaged when competing with foreign lenders. Foreign lenders, who are not subject to the close scrutiny which American lenders are, have constantly over-extended the margin to their borrowers.⁸⁹ Since borrowers were not subject to the margin requirement law, they were not liable for any violation of the previous Act. The section of Title III which imposes civil and criminal penalties upon the borrower will have little effect unless it can be proved that the foreign borrower over-extended the permissible margin requirements. In cases where the bank secrecy laws of other nations prevent the U.S. from obtaining the records of foreign accounts, Title III will prove ineffective.

F. Summary

The Bank Secrecy Act was enacted to curtail the covert transfer

83. Title III is an amendment to the Securities and Exchange Act of 1934, 15 U.S.C. §78(g) (1970).

84. 15 U.S.C. §78 (1970).

85. Bank Secrecy Act, §301, 15 U.S.C. §78(g) (1970).

86. 12 C.F.R. §224.2(a) (1975).

87. 12 C.F.R. §220.8 (1975). Supplement to SEC Reg. T, 12 C.F.R. §220.8 (1975).

88. Since *Metro-Goldwyn-Mayer Inc. v. Transamerica Corporation*, 303 F. Supp. 1354 (S.D.N.Y. 1969), when it was decided that the law only applied to lenders and not to borrowers, borrowers have been able to violate margin requirements without criminal liability.

89. Bank Secrecy Laws in foreign nations are generally such that financial institutions in those nations are not closely scrutinized. They can therefore violate U.S. margin requirements since activities are shielded by bank secrecy laws.

of illegally obtained funds. The prevalent practice of depositing covert funds in non-recordkeeping financial institutions, and withdrawing those funds from foreign accounts protected by that nation's bank secrecy laws, will be limited by strict enforcement of the Act. If, for example, a withdrawal is made in Curacao and the funds are deposited in New York, there will be a record in New York documenting this transfer. To avoid recordkeeping, the money will have to be surreptitiously transported out of the United States as a physical entity, not as a negotiable instrument. If the money is transported without first being reported, then the transfer is illegal, and if the currency is intercepted, separate grounds for criminal prosecution exist.⁹⁰ If the physical transfer is reported, then there is no advantage of the physical transfer over a transaction through a recordkeeping financial institution. However, as has been pointed out, the Bank Secrecy Act in itself is not enough — cooperation from other nations is also needed.

III. UNITED STATES-SWITZERLAND: TREATY ON MUTUAL ASSISTANCE IN CRIMINAL MATTERS

Switzerland's signing of the Treaty on Mutual Assistance in Criminal Matters represents a departure from previous Swiss banking practice.⁹¹ The Treaty's acceptance may have been augured by

90. See note 73 *supra*.

91. See Comment, *Swiss Banking Secrecy*, 5 COLUM. J. TRANSNAT'L L. 128 (1966); Comment, *Secret Swiss Bank Accounts: Uses, Abuses and Attempts at Control*, 39 FORD. L. REV. 500 (1971); Friedrich, *The Anonymous Bank Account in Switzerland*, 1962 J. BUS. L. (Eng.) 15; Mueller, *The Swiss Banking Secret*, 18 INT'L & COMP. L. Q. 360 (1969). In order to fully understand the importance of the Treaty with Switzerland one must first understand Switzerland and its bank secrecy laws. The Swiss regard for the right of privacy in one's personal and financial affairs has its roots in the Middle Ages and has progressed to where that right is now protected by criminal statute. Furthermore, unlike most bank secrecy nations, the Swiss even apply the right of privacy against their own government. This right became codified during the 1930's when Nazi Germany attempted to investigate the assets held in Switzerland by Jewish people and other "enemies of the State" in Article 47(b) of the Banking Law:

Anyone who in his capacity as an officer or an employee of a bank, or as an auditor or his employee, or as a member of the banking commission or as an officer or an employee of its bureau intentionally violates his duty to observe silence or his professional rule of secrecy or anyone who induces or attempts to induce a person to commit any such offense, shall be liable to a fine of 20,000 francs or imprisonment of up to six months or both. If the offender acted with negligence he shall be liable to a fine up to 10,000 francs.

However, what has earned Switzerland the title of leader in bank secrecy is due more to Switzerland's importance as a banking center than to any other factor.

While the Swiss will give assistance in civil and criminal matters under the Hague

X v. The Federal Tax Administration, a rare example of Swiss defiance of their bank secrecy laws.⁹² It seems clear, however, that the Treaty was motivated by the tremendous influx of illicit funds into Switzerland.⁹³

Under the Treaty a reasonable suspicion that the elements of a particular offense have been committed is the only prerequisite for a request for assistance by the country where the crime has occurred.⁹⁴ This assistance may include the taking of depositions, location of persons, service of judicial and administrative papers and production and authentication of documents.⁹⁵ The Treaty does not extend to military or political offenses, cartel or anti-trust violations, and tax, custom duty, government monopoly or exchange

Convention, the Swiss have reserved the right not to aid in matters of administrative law, and any investigation which would violate the Swiss *ordre public*. The Swiss consider income tax evasion an administrative matter and do not provide assistance in this area. Furthermore, Swiss banks will not provide assistance when the information is not compelled to be distributed under cantonal law.

92. Under the Convention Between United States-Switzerland for the Avoidance of Double Taxation with Respect to Taxes On Income, May 24, 1951, 2 UST 1753, information will be exchanged between the United States and Switzerland when a violation of the Convention has occurred. The Convention is limited to the very narrow area of the taxation of persons and businesses of one nation who do business in the other.

In *X v. The Federal Tax Administration*, U.S. Tax cases (71-1, at 86566) 9435 (Swiss Federal Supreme Court, Dec. 23, 1970, Unofficial CCH translation), the veil of bank secrecy began to crack as the Swiss gave out information for the first time under the Convention. In this case the I.R.S. claimed that it had reason to suspect that X, an American citizen, had defrauded the U.S. tax authorities. An investigation by the Swiss Federal Tax Administration confirmed the I.R.S. suspicions.

X unsuccessfully argued that since no action for tax fraud was pending against him in the United States the Swiss should not give out the information; the Court held "(i)t is essential only that there be a suspicion, sustained by the facts, that fraud or the like has been committed or such illegal act is planned." 71-1 at 85658.

The second and major issue in the case was whether under Swiss law a bank must give out information concerning a possible tax fraud. The Swiss Federal Supreme Court decided that since the Convention was federal law, the American negotiators had reasonably assumed that the Convention would apply to tax fraud cases. This assumption was based upon the fact that the three major banking centers in Switzerland were located in cantons which had tax fraud laws.

This decision altered over twenty years of Swiss policy without changing the basic principles of Swiss law. While the Swiss had always denied assistance in tax evasion cases under the Convention this case allowed aid in a tax fraud case after a reasonable suspicion had been shown. See also Note, *Swiss Accounts*, 38 BROOK. L. REV. 389 (1971).

93. See Recent Treaties, 7 VAND. J. TRANSNAT'L 469 (1974); Note, *Judicial Assistance—Criminal Procedure*, 15 HARV. INT'L L.J. 349 (1974); Comment, *The Recent Swiss-American Treaty to Render Assistance in Criminal Law Enforcement: Panacea or Placebo?*, 7 N.Y.U. J. INT'L L. & POL. 103 (1974).

94. See Treaty, *supra* note 6, art. 1, §2.

95. *Id.* art. 1, §4.

control violations.⁹⁶ These exclusions (with the exception of military offenses) do not apply when organized crime is involved.⁹⁷ Throughout the Treaty, such special treatment of organized crime strongly evidences both governments' concern with this problem.

Assistance will be discretionary to the extent that the aiding state feels that its "sovereignty, security or similar essential interests" are prejudiced.⁹⁸ If a request for assistance is made for the purpose of prosecuting a person who has been acquitted or convicted of substantially the same charge in the requested state,⁹⁹ assistance is discretionary as well, except in organized crime cases.¹⁰⁰

Evidence will be furnished, and criminal investigations conducted, pursuant to the normal practices of the state giving assistance.¹⁰¹ Any testimony, documents, records or other articles of evidence produced by the requested state may be used only in relation to the offense for which assistance was granted.¹⁰² An exception exists when the evidence is used to prosecute or investigate accomplices to the same crime for which assistance was granted, or when the investigation or trial is for another offense for which assistance has been granted or concerns a member of organized crime.¹⁰³

There is a special section on "organized crime"¹⁰⁴ which illustrates the two nations' concern with the increased power of organized crime. Another section of the Treaty allows assistance for any violation of the tax laws of the requesting state if an individual is

96. *Id.* art. 2, §1.

97. *Id.* art. 2, §2.

98. *Id.* art. 3.

99. *Id.*

100. *Id.*

101. *Id.* art. 4.

102. *Id.* art. 5.

103. *Id.* In the case that any of these exceptions apply, however, the requested State should first have the opportunity to have its views heard.

104. *Id.* arts. 5-7. Article 6(3)a defines "organized criminal group" as:

... an association or group of persons combined together for a substantial or indefinite period for the purposes of obtaining monetary or commercial gains or profits for itself or for others, wholly or in part by illegal means, and of protecting the illegal activities against criminal prosecution and which, in carrying out its purposes in a methodical and systematic manner: (a) at least in part of its activities commits or threatens to commit acts of violence or other acts which are likely to intimidate and are punishable in both States; and (b) either (1) strives to obtain influence in either politics or commerce, especially in political bodies or organizations, public administration, the judiciary, in commercial enterprises, employers' associations, or trade unions or other employees' associations; or (2) associates itself formally or informally with one or more similar associations or groups at least one of which engages in activities described under subparagraph b(1).

suspected of being in the "upper echelon" of an organized crime group or is an important person in such a group.¹⁰⁵ "Organized crime" and "upper echelon" are defined broadly, thereby allowing a wide degree of flexibility for both nations to fit persons into the definition.¹⁰⁶

There is, however, a limitation on bank secrecy requests when the evidence, although permissible, does not concern a party directly connected with the offense.¹⁰⁷ In these cases the request will be complied with only when the investigation or prosecution is of a serious offense, the disclosure is important to the investigation or proceeding and the requesting nation has made reasonable attempts to obtain the evidence in other ways but has not been successful.¹⁰⁸ Under the Treaty there exists an interesting possibility for the prosecution of violators of the U.S. tax laws. Although a first reading of the Treaty seems to preclude the Swiss government's assistance in any tax matters unrelated to organized crime, a contrary interpretation is possible.

Article II, section I(c)(5) of the Treaty, and Item 34 of the accompanying Schedule of Offenses for which compulsory assistance is required, may provide an exception to the ban on information in tax matters. Item 34 incorporates the previous 33 items, among which is listed the offense of fraud. The examples of fraud provided by Item 19, although not totally inclusive of the types of fraud covered by the Treaty, do not contain any examples of tax fraud.¹⁰⁹ Furthermore, in the case of tax fraud, to interpret Item 34 as including the previous 33 items would render the Article 2 tax exclusion meaningless.¹¹⁰

The Swiss Treaty should prove beneficial in prosecuting viola-

105. *Id.* art. 6 §§2-3. See 68 DEP'T STATE BULL. 947 (1973).

106. See note 101 *supra*.

107. *Id.* art. 10, §2.

108. *Id.*

109. *Id.* Item 19 of the Schedule:

Fraud, including:

- a. obtaining property, services, money or securities by false pretenses or by defrauding by means of deceit, falsehood or any fraudulent means;
- b. fraud against the requesting State, its states or cantons or municipalities thereof;
- c. fraud or breach of trusts committed by any person;
- d. use of mails or other means of communication with intent to defraud or deceive, as punishable under the laws of the requesting State.

110. To interpret item 34 as always including the previous 33 items would make no sense since it is referred to in the Articles granting immunities from prosecution as one of the few offenses to which the immunity does not apply.

tors of the Bank Secrecy Act. The Treaty will make it possible to receive information on violations of the Act which put funds into Swiss bank accounts.¹¹¹ Whether or not this will prove to be a viable solution to all the problems which both the Act and the Treaty were enacted to solve is another matter.

IV. THE NEED FOR THE CHANGES AND THEIR EFFECTS

A. The Evasion of Taxes

The former United States attorney for the Southern District of New York, Robert Morgenthau, characterized the secret foreign bank account "as the largest single tax loophole permitted by American law."¹¹² By using the secrecy of foreign accounts the tax evader has been able to successfully frustrate American tax laws. This practice is unfair since most Americans faithfully pay their taxes and it is generally the wealthy who are able to partake of this practice.¹¹³ Furthermore, although tax investigations and convictions have been one of the major devices in prosecuting leaders of organized crime, this, too, has been stymied by lack of recording requirements and the use of foreign bank secrecy laws abroad.¹¹⁴

One of the major problems which the Bank Secrecy Act and the Swiss Treaty tried to alleviate is income tax evasion. The Treaty will help only when organized crime is involved.¹¹⁵ While tax information will still be provided under the United States-Switzerland Double Taxation Convention,¹¹⁶ this Convention's scope is limited and will only affect a small number of cases.

The ways in which a taxpayer can avoid taxes through the use of secret bank accounts are limited only by his imagination.¹¹⁷ It is possible, however, to group the methods of avoidance into three major categories: the transfer of funds out of the United States which were not reported as income,¹¹⁸ the use of foreign bank

111. See text of Section II. The reason for this is that it is a violation of criminal law to violate the Bank Secrecy Act.

112. See note 2 *supra* at 4398 and note 8 *supra*.

113. See note 8 *supra*.

114. Note, *Secret Foreign Bank Accounts*, 6 TEXAS INT. L.F. 105, 108 (1970) (hereinafter cited as *Secret Accounts*).

115. See note 105 *supra*.

116. See note 92 *supra*.

117. A taxpayer can have non-reported income which could have been earned legally or illegally sent directly to his secret foreign bank account, or can use the account to generate false deductions.

118. See notes 121-125 *infra* and accompanying text.

accounts to generate false deductions on illegitimate business transactions,¹¹⁹ and the direct deposit of income-generating assets in foreign accounts.¹²⁰

1. TRANSFER OF FUNDS

Under the first method of tax avoidance, earnings and profits are illegally transferred out of the United States into secret foreign bank accounts and never declared as U.S. income. As was previously stated, under the Bank Secrecy Act, all such transactions will be recorded by the financial institutions and, if the transfer is large enough, it may be reported to the Treasury Secretary. If the funds are illegally transferred through a courier, the sending party will risk both forfeiture of the entire transfer and possible criminal prosecution if the courier is intercepted.¹²¹ However, the Swiss Treaty will not help solve this problem unless either organized crime is involved¹²² or the funds have been transferred in violation of the Bank Secrecy Act.

An interesting situation arises when illegally earned money is transferred out of the United States. Under U.S. tax law all income must be reported.¹²³ Assuming, however, that the illegally obtained and transferred funds were not reported as income to the Federal Government, assistance may be requested from the Swiss government, under the Treaty, on three different bases: the fraud theory; violation of the Bank Secrecy Act; and suspicion of criminal activity in obtaining the funds.¹²⁴ Assuming the U.S. Congress ratifies the Treaty, however, persons who desire the safety and refuge of the secret foreign bank account may merely move their accounts to another foreign nation which is more receptive to their needs.¹²⁵ Thus, the success in stopping this type of income tax evasion rests squarely upon the Bank Secrecy Act until all nations of the world revise their bank secrecy laws.

119. See notes 126-132 *infra* and accompanying text.

120. See notes 133-138 *infra* and accompanying text.

121. Bank Secrecy Act, §210, 31 U.S.C. §1059 (1970).

122. Treaty, *supra* note 6, art. 6.

123. Int. Rev. Code of 1954, §61.

124. If the money is illegally earned and smuggled out of the United States contrary to the Bank Secrecy Act, the United States could ask the Swiss for information concerning the violation of the Act and the other crime and thus avoid the problem of not being aided in the tax request.

125. Curacao, the Bahamas and Panama would be leading contenders for the money.

2. FALSE DEDUCTIONS

A common example of the false deduction scheme occurred when a taxpayer claimed, as a bad debt deduction,¹²⁶ the failure of a foreign corporation to repay a loan, when in fact the corporation was owned by the taxpayer and organized for the express purpose of making the loan. The loan was simply a payment, by the taxpayer to himself, which was placed in a foreign bank account.¹²⁷ In another case a taxpayer claimed an interest deduction on a loan which he had taken out from a foreign corporation. The money went from one secret account to another, both of which were entirely under the taxpayer's control.¹²⁸ Other cases involve the non-reporting of stock transactions, capital gains and false deductions.¹²⁹

Swiss banks have been very helpful to their depositors in setting up illegitimate transactions. The banks lend the depositors their own money so that the depositors will have an explanation for the source of their funds.¹³⁰ When the Internal Revenue Service questions the source of the funds, the recipient claims that it was a loan, and hence not taxable income.¹³¹

Both the false deduction and false source schemes involve income tax fraud. The Swiss Treaty will only help if the fraud argument is accepted by the Swiss.¹³² It is probable that the Treaty will not alleviate this type of tax evasion unless organized crime is involved. The Bank Secrecy Act will not remedy the problem because the funds were not illegally transported out of the United States.

There are two potential solutions to the tax evasion problem. The Swiss could interpret the Treaty broadly to cover income tax problems, or the Internal Revenue Service could disallow any such deduction unless the taxpayer permits investigation of the foreign accounts which gave rise to the deduction. The first of these solu-

126. The taxpayer would lend money to a corporation which he entirely owned. The corporation would then default on the loan and the taxpayer would get a bad debt deduction. The taxpayer would also get the money, since he owned the corporation, from the firm's secret foreign bank account.

127. *Senate Subcommittee Hearings*, *supra* note 8, at 266.

128. *Id.* See also 266-67.

129. *Id.* See *U.S. v. Campbell*, 351 F.2d 336 (2d Cir. 1965), *cert. denied*, 383 U.S. 907 (1966) for capital gains example.

130. See *Secret Accounts*, *supra* note 114, at 126.

131. Since the source of the funds was a secret foreign bank account, the Internal Revenue Service would be unable to prove that the money "lent" to the taxpayer was earned by him and not reported as income.

132. The Bank Secrecy Act will not have been violated since the money was not from the United States.

tions is improbable in light of the history of the Swiss bank secrecy laws and their regard of tax evasion as an administrative matter to which their restrictive bank secrecy laws often apply. The second solution appears to be the better alternative because it places the burden on the taxpayer to prove the legitimacy of the deduction.

Even given a liberal Swiss interpretation of the Treaty, or an acceptance of the fraud theory, as long as banks in other nations function as safe repositories for these funds, the second solution will be necessary to remedy tax fraud. There is a clear need for a multi-lateral treaty designed to establish uniform bank secrecy laws.

3. INCOME SENT DIRECTLY

Under the third method of tax avoidance, depositors transfer the title to assets, typically real estate or mortgages, to their Swiss banks in an effort to avoid taxation on the annual income and the eventual capital gain.¹³³ This method is particularly profitable because many of the countries which have secrecy laws either have no income tax or the tax rate is substantially lower than the U.S. rate.¹³⁴ In addition, citizens have established dummy trusts and corporations to serve as repositories for their incomes,¹³⁵ and U.S. investors have evaded taxes by trading their profits through secret Swiss bank accounts.¹³⁶

133. See *Secret Accounts*, *supra* note 114, at 112.

134. Panama, Curacao, Lichtenstein and the Bahamas are notorious for having secret banking facilities. See also *Hearings on Foreign Bank Secrecy and Bank Records on H.R. 15073 Before the House Committee on Banking and Currency*, 91st Congress, 1st and 2d Sess. at 18-20 (1970) (hereinafter cited as *Hearings #1*); *Senate Subcommittee Hearings*, *supra* note 8, at 261.

135. *Hearings on the Legal and Economic Impact of Foreign Banking Procedures on the United States Before the House Committee on Banking and Currency*, 90th Congress, 2d Sess. at 14 (1968) (hereinafter cited as *Hearings #2*). Statement by Robert Morgenthau at 14.

Salesmen earning commissions from U.S. manufacturers for sales overseas have sometimes worked out a slightly more complicated device, as exemplified in a recent indictment which our office obtained. These salesmen set up a dummy Lichtenstein trust with a Swiss bank account. A Lichtenstein lawyer who serves as the chief executive of hundreds of such trusts became the ostensible head of the foreign entity. The salesmen advised the U.S. manufacturers, and these included leading American manufacturers, that most of the selling would be done in the future by the Lichtenstein corporation and directed that the major portion of the sales commissions earned should be sent to Lichtenstein rather than to the U.S. salesmen. This money was deposited by the Lichtenstein lawyer in the Swiss bank. In this manner, the U.S. taxpayers fraudulently evaded taxes on over \$3 million unreported income in just over 3 years.

136. *Id.* Again Morgenthau pointed out:

Numerous U.S. investors have undertaken to avoid profits by trading their profits

The Bank Secrecy Act will have no effect on this type of transaction if the money is earned abroad. If, however, the money is earned in the United States and is transferred to a foreign bank account under the guise of being earned by a foreign citizen, then the Act will apply, as the transfer of funds through the banking system was transacted under a false identity.¹³⁷ In these situations, the Swiss Treaty will be helpful once a reasonable suspicion of criminal activity has been established.

If the funds are declared as income by a Swiss account, trust or corporation, then the Double Taxation Convention will have been violated and following the *X v. Federal Tax Administration*¹³⁸ doctrine the Swiss will aid the U.S. Government's investigation. Obviously, if the fraud takes place within another nation's secret account, no cooperation can be expected.

B. Stocks and Securities

In 1966 Congress passed the Foreign Investment Tax Act¹³⁹ which was intended to encourage foreign investments.¹⁴⁰ Under the Foreign Investment Tax Act, a foreign corporation, whose sole activity

through Swiss bank accounts. The investor need only open an account in Switzerland and cable or mail trading instructions. The bank maintains huge accounts with U.S. brokers and executes orders each day through these brokers on the appropriate U.S. stock exchange. The U.S. broker has no indication of the identity of the Swiss bank's client.

This system is ideal for the investor seeking long-term growth, since the loss of a day cabling his order to Switzerland and back to New York will not be of great significance to him.

Many New York brokers deal in such large volumes for Swiss banks that they maintain open telex lines or talk on the telephone several times a day. It has therefore been arranged for the trader to deal with a broker—sometimes using a code name—and give his order to buy or sell X security. The broker arranges immediately to receive such an order from Switzerland for an unknown customer of the Swiss bank and executes the order as if he had it from Switzerland for an unknown customer of the Swiss bank. The broker's only written confirmation will go to Switzerland but he can advise the trader by phone of the completed transaction. To facilitate the trading, the Swiss bank can maintain the trader's account as a subaccount at the broker rather than as part of its general account. Thus, the broker might have one account labeled Bank X, subaccount 1, 2, 3, etc. He would still receive the ostensible orders covering these accounts from Switzerland and have no records identifying the true owner of the account.

137. This is so because the beneficial owner of the money would not have been identified. The same will hold true if the funds are transported without the beneficial owner being identified.

138. See note 92 *supra*.

139. 26 U.S.C. §861(b) (1970).

140. *Senate Subcommittee Hearings, supra* note 8, at 262.

ity in the United States is in the securities field, is not subject to U.S. taxation. While the act has stimulated foreign investment in the United States, the corporate investors are beyond the reach of the Securities Exchange Commission and other law enforcement agencies.¹⁴¹ "As a result, in the long run . . . the practical reach of the law may be detrimental to American investors, to foreign investors in the American market and ultimately to the balance of payments itself."¹⁴²

In effect, the Foreign Investment Tax Act made it more lucrative for Americans to invest in corporate stocks and securities through secret foreign accounts. This has, in fact, become a prevalent practice.¹⁴³ In one case, margin requirements were violated when brokers handled a Swiss bank's account in which three registered representatives and a senior partner had purchased stock in violation of the margin requirements.¹⁴⁴ The same pattern was repeated in the *HOMCO*¹⁴⁵ case where provisions of Regulation T were violated.¹⁴⁶

The problem arises because foreign banks can buy securities for unnamed investors without disclosing the margin. American and foreign investors have purchased stock through foreign banks under overextended margin circumstances. The banks then purchase the securities through American brokerage houses and the illegal activity goes undetected.

In addition to its regular deposit and credit activities, almost every Swiss bank may act as a broker and dealer in securities for its customers.¹⁴⁷ The banks maintain securities with American brokerage houses under the bank's name, thereby making it impossible to ascertain the owner of each security.¹⁴⁸ Because of this trading system the possibility of fraud is substantially increased.¹⁴⁹

Title III of Public Law 91-508, in combination with the Swiss Treaty will help to alleviate this problem once a reasonable suspicion of criminal activity is established. The problem is creating the reasonable suspicion. Once this has been accomplished, since the

141. *Id.*

142. *Id.*

143. See *Hearings #1, supra* note 134, at 19-23.

144. *Id.* at 23.

145. *Id.* at 24. See also *Secret Swiss Bank Accounts, supra* note 91, at 506.

146. SEC Reg. T, 12 C.F.R. §220.4(b) (1975), SEC Reg. T, 12 C.F.R. §220.8(a)(1) (1975).

147. *Senate Subcommittee Hearings, supra* note 8, at 73-91.

148. *Hearings #2, supra* note 135, at 6.

149. *Id.*; *Senate Subcommittee Hearings, supra* note 8, at 263.

American borrower has violated the margin requirements of Title III, the Swiss Treaty will allow the Swiss to aid the U.S. Government. If the United States does approve the Treaty, however, the borrowers will probably avoid incrimination by taking their business from Swiss accounts to other nations with bank secrecy laws.

Swiss banks have also been used to perpetrate securities frauds on the American public. A classic example is the *Gulf Coast Leaseholds*¹⁵⁰ case in which "four 'Lichtenstein trusts' holding Swiss bank accounts were instrumental in a scheme by American promoters to sell 750,000 shares of unregistered over-the-counter stock to the American public at prices manipulated to over \$16 a share."¹⁵¹ After the promoters had taken their profits the price dropped to under one dollar per share. Each of the trusts were American-owned with a Swiss lawyer acting as the titular head. Because of the Swiss bank secrecy law the identity of the trusts' principals and owners were concealed successfully.¹⁵² In addition, Swiss bank accounts have been used in the sales of stolen securities.¹⁵³ While in the latter two cases the Bank Secrecy Act is inapplicable, since fraud is involved, the provisions of the Swiss Treaty will apply after a reasonable suspicion of illegal activity has been established.

Through the bank secrecy laws of other nations corporate insiders have illegally traded stock without filing the required forms,¹⁵⁴ stocks have been purchased in violation of the margin requirements, criminals enjoined from trading on the stock exchanges have done so and stolen and valueless securities have been traded. These practices have occurred in a market where foreign investment accounted

150. *United States v. Kelley*, 349 F.2d 720 (2d Cir. 1965), cert. denied 384 U.S. 947 (1966).

151. *Hearings* #1, *supra* note 134, at 20.

152. *Id.* See also *Hearings* #2, *supra* note 135, at 12, and see *United States v. Hayutine*, 398 F.2d 944 (2d Cir. 1966), cert. denied, 391 U.S. 961 (1968). In this case, known as the Allied Entertainment case, prohibitions against unregistered stock were circumvented when the stock was delivered to a Munich bank which in turn sold the stock to the American public through brokerage firms in which the bank had accounts. The insiders of the corporation had manipulated the stock to an artificially high price and then covered up their trail by depositing the funds in the Frankfurt branch of the Chase Manhattan Bank. From there the funds were transferred to the swindlers' Swiss bank account in Munich. Thus insiders were able to circumvent U.S. laws requiring the filing of reports.

153. See *Secret Accounts*, *supra* note 114, at 109. See also *United States v. Blackwood*, 456 F.2d 526 (2d Cir. 1972), where six were indicted for selling stolen securities through a Swiss bank, and *United States v. Phillip L. Bradford and Walter Fink*, 62 Cr. 100 (1965), where \$50,000 in stolen securities were exchanged for currency by a Swiss bank. See also 116 CONG. REC. 16951 (1970).

154. See note 152 *supra*.

for purchases of \$12.5 billion and sales of \$11 billion of common stock in 1969.¹⁵⁵ Moreover, many Americans involved in these schemes never had to leave the country in order to deal through the foreign banks and take advantage of existing secrecy laws.

A Treaty with Switzerland is ineffectual as long as there are other foreign nations to which investors can turn. The U.S. Senate recommended a bill stipulating that all foreign investors identify any Americans for whom they are buying stocks.¹⁵⁶ This bill would have been helpful, except that shrewd investors desiring to circumvent the law would undoubtedly have the stock purchased by someone else. Rather, a bill is needed combining the Senate proposal with a requirement that all margins extended also be identified. Even if such a bill is passed, it will have little effect unless the foreign bank secrecy nations help the United States enforce it or all parties purchasing U.S. stocks sign waivers permitting the Government to investigate their foreign bank accounts if a reasonable suspicion of illegal activity exists.

C. Organized Crime¹⁵⁷

Organized crime has been a primary beneficiary of foreign bank secrecy laws. Swiss accounts have become depositories for the proceeds of heroin¹⁵⁸ and other narcotics transactions.¹⁵⁹ In addition,

155. Senate Subcommittee Hearings, *supra* note 8, at 87, Statement by Hamar Budge, Chairman of the Securities and Exchange Commission.

156. S. REP. NO. 91-1139, *supra* note 9, at 2.

157. For a definition of "organized crime" see note 104 *supra*.

158. 116 Cong. Rec. 16956 (1970):

The secret bank accounts are an integral part of the heroin trade. Money received for the sale of heroin in the United States is either carried to Europe by a courier or hand carried to a New York bank or money exchange where it is forwarded to an account in a Swiss bank. There, the money is transferred to the account of the heroin supplier.

Former U.S. Atty. Robert Morgenthau cited a recent heroin case where a part of the payoff for smuggling heroin, \$950,000, was sent to the Swiss bank account of a Panamanian corporation with offices in Geneva.

For organized crime, the secret foreign bank accounts are used to conceal the profits of crime and to facilitate carrying out such international crimes as narcotics trafficking, smuggling, black market currency operations in Southeast Asia and illegal trading in gold.

Eugene T. Rossides, Assistant Secretary of the Treasury for Enforcement and Operations, says that there's strong evidence of a substantial flow of funds from U.S. racketeers, particularly those associated with gambling to certain foreign banks.

"Some of the funds," he said recently, "appear to have been brought back into the U.S. under the guise of loans from foreign sources. This may be providing a

organized crime uses secret accounts for revenues generated by gambling operations, loan sharking, prostitution, untaxed liquor,¹⁶⁰ skimmed profits from Las Vegas casinos,¹⁶¹ and bribes and kickbacks.¹⁶² The illicit funds are then used for financing new ventures and the takeover of legitimate businesses.¹⁶³ More importantly, organized crime owns some of the foreign banks which use the secrecy laws to shield illegal activities.¹⁶⁴ By virtue of the foreign bank secrecy laws and the former lack of U.S. record-keeping requirements on the import and export of currency, organized crime has found a safe repository for its money, anonymity for itself and a legitimate place from which to finance future operations. The secrecy of the accounts frustrates any attempts at discovering the identity of the persons owning the accounts even after the money has been traced.

The Bank Secrecy Act, in conjunction with the Treaty, should substantially interfere with organized crime's use of Switzerland as the repository for its funds. The only exception to the application of the Treaty is identifying offenses. Irrespective of what other of-

substantial source of funds for investment by the criminal elements in legitimate business in the United States."

159. *Hearings #1, supra* note 134, at 25. In one case heroin was smuggled into the United States in airplane lavatories while payment was transferred into secret European bank accounts by couriers from other secret accounts.

160. See note 158 *supra* at 16955.

161. *Id.* at 16952, 16955.

162. See *U.S. v. Ohio Mathieson Chemical Corporation*, 368 F.2d 525 (2d Cir. 1966) for kickbacks; *U.S. v. Armantrout*, 411 F.2d 60 (2d Cir. 1969) for a case involving consumer frauds; *U.S. v. Cohen*, 37 F.R.D. 26 (S.D.N.Y. 1965) for a case involving fraudulent financial statements — these were not organized crime cases, however.

163. See note 158 *supra* at 16955-56. Organized crime has also used foreign bank accounts for the illegal trading of gold, in all types of public and business activities, including the military in Vietnam.

164. *Senate Subcommittee Hearings, supra* note 8, at 246. Statement by Robert Morgenthau:

A startling development of recent years has been a significant change in the identity and ownership of foreign banks. Today numerous banks in Switzerland and the Bahamas are owned and controlled not only by Americans, but in some cases by American hoodlums closely linked to loansharking, gambling rackets, and other illegal activities. Such a bank does not need a large working capital to be a useful element of an illegal business. Its function is not to provide funds for the business as much as to provide an unreachable depository for illegal profits. Such a bank might even not keep its accumulated funds on deposit, but might well redeposit them in a more substantial foreign bank or even a U.S. bank. An American criminal who is not content simply to accumulate wealth in a foreign bank can easily and safely cause the bank to "lend" it back to him. These devices and many others are all at the disposal of this growing number of "foreign" banks controlled or connected with the Americans and the American underworld.

fense is suspected of being committed, once a reasonable suspicion of criminal activity has been shown, the Swiss will assist the United States in prosecuting organized crime and its members. The Treaty will be superior to other Swiss law, since a treaty or convention becomes federal law and in Switzerland federal law is superior to cantonal law.¹⁶⁵

V. CONCLUSION AND PROPOSED SOLUTIONS

The Bank Secrecy Act and the Swiss Treaty were passed as remedial legislation intended to prevent the use of foreign bank accounts as repositories for illegally acquired funds. Although some covert activities will be affected by these measures, they are by no means a complete solution to the problem.

In the area of income tax evasion, the recording requirements of Title I will prevent the use of U.S. financial institutions as a device through which funds can be channeled into foreign bank accounts. Title II of the Act, however, will probably be unenforceable. The cost of preventing the physical transfer of funds into or out of the country will prevent this section of the Act from acting as an effective deterrent to illegal activity.

The Swiss Treaty will serve to limit income tax evasion only when it can be shown that there is a reasonable suspicion that the Bank Secrecy Act has been violated. The Swiss will probably not render any assistance in tax matters unless either organized crime is involved or there is a violation of the Double Taxation Convention.

Neither the Bank Secrecy Act nor the Swiss Treaty will assist in the prosecution of those taxpayers who use foreign bank accounts to generate false deductions through non-existent business transactions. Finally, in the case of Americans whose incomes are sent directly to foreign bank accounts, the Bank Secrecy Act will only be helpful if that income had been sent from the U.S. mainland. An effective way for the Government to deal with the problem of false deductions would be for the Internal Revenue Service to disallow any deductions which are generated in foreign nations unless the taxpayer expressly gives the Internal Revenue Service permission to investigate his accounts. This would circumvent the problem that exists with respect to nations which allow the maintenance of secret bank accounts.

165. See note 92 *supra*.

Title III of the Act does not adequately deal with security problems. While the Title does extend liability for the violation of margin requirements to the borrower, enforcement of this provision will prove difficult. The U.S. Government has no way of identifying the actual purchaser of securities when foreign banks act as an intermediary in the transaction. The U.S. broker who has sold the securities to the foreign bank cannot ascertain the identity of the person for whom the foreign bank has purchased the stock.

All foreign banks and investors who purchase stock should be required to give the S.E.C. a detailed list of any beneficial or legal owner of the purchased stock. Violators of this provision must be punished by severe criminal and civil sanctions. Furthermore, all foreign purchasers should be required to sign a waiver of foreign bank secrecy laws with respect to their transaction in the event that a reasonable suspicion of margin violation occurs. It would also be beneficial to sign treaties with other nations allowing the United States access to any foreign bank account when there is a reasonable suspicion that the Securities and Exchange Acts of 1933 or 1934 have been violated. In addition, when foreign investors seek to sell large blocks of stocks and securities, the S.E.C. should be notified in an effort to prevent stolen stocks and securities from being sold through foreign accounts.

The Swiss Treaty is an effective device to combat organized crime. Since under its terms any crime, other than military offenses, will elicit the full cooperation of the Swiss government, this section of the Treaty would be an ideal model to use in negotiating similar treaties with other foreign bank secrecy nations.

In summary, the Bank Secrecy Act, Title III of Public Law 91-508, and the Swiss Treaty are the first step in the drive to end foreign bank secrecy. However, further development in this area is needed before the problems of secret foreign bank accounts will be completely remedied.

Milton Steven Blaut