BANK PRIVACY

US Legal Threats and Offshore Opportunities

Bill Rounds, Esq.

LEGAL DISCLAIMER

This is intended to be a general discussion only, and must not be considered legal advice. Your use of it does not create an attorney-client relationship. Any liability that might arise from your use or reliance on this is expressly disclaimed. This is not legal, loan, accounting or tax advice, and is not to be acted on as such. All readers are advised to seek services of competent professionals familiar with their unique circumstances.

Financial privacy is as important as personal privacy. It can be difficult to protect financial privacy because we must entrust others (banks) with our sensitive and valuable financial information and assets. In fact, the information about our financial transactions is itself an asset and many institutions sell that data. So to have financial privacy we must enter into confidentiality agreements and rely on others to honor those agreements. The modern legal environment in much of the world makes protection of this vital privacy interest very difficult. The US and other countries prevent, or at least severely limit, many financial institutions from entering into confidentiality agreements at all by requiring

significant disclosures to government officials about your financial activity.

There are still ways to preserve much of your own financial privacy. **First**, a general understanding of the threats to financial privacy posed by US law and a knowledge of what kinds of behavior and transactions trigger mandatory reporting requirements can help you understand how to manage your affairs to reduce your exposure to these privacy destroying requirements. **Second**, an overview of foreign jurisdictions that have legal and cultural environments more favorable to protecting your privacy can help you develop a strategy for protecting your financial privacy in their jurisdiction.

THE US LEGAL ENVIRONMENT

DISCLOSURES TO PRIVATE ENTITIES

Bank privacy issues in the US can be divided into two tiers. The first tier of privacy issues concerns the disclosure of information about your account and your transactions to other private corporations, often for marketing purposes. Almost everyone with a US bank account will have some of their personal information disclosed by their financial institutions to other companies if they do not take affirmative steps to avoid such disclosure. Even if you have taken the steps necessary to minimize these disclosures, much of your information will be shared with other companies anyway. These disclosures lead to increased junk mail in your mailbox, unwanted product and service offers and unwanted charges for these products and services authorized by your bank, not by you. This can be a severe and expensive annoyance.

These information exchanges are permitted under US law and it is a common practice of almost all financial institutions in the US to exchange customer information. There are limits imposed[1] by law

[1] 15 United States Code (U.S.C.) §§ 6801-6809

which require that your financial institution inform you of their privacy policy and give you the opportunity to opt out of information exchanges with "nonaffiliated third parties."[2] It is important to your privacy to always opt out of these policies. There will still be some information sharing among "affiliates" of your financial institution, even when you choose to opt out, but the level of disclosure will be greatly reduced.

Individual states may enact stricter laws to protect consumer privacy and individual banks are permitted to have policies that restrict the exchange of information more than what has been required by federal law. There are, however, no large banks that materially limit their information exchange program more than what is minimally required by Federal law. Therefore, this disclosure of information to other private entities remains a risk to your privacy.

DISCLOSURE TO PUBLIC ENTITIES

The second tier of privacy concerns are those that form the legal environment in which the modern banking system operates in the US. These laws impose requirements on banks and individuals which limit the ability of banks and individuals to create private banking relationships. Following is an overview of the main provisions of US law which affect bank privacy in the US.

[2] 15 U.S.C. §§ 6802-6803

KNOW YOUR CUSTOMER

Banks cannot open an account unless the customer provides suitable identification. Once identification is provided, the bank is required to conduct a thorough investigation to verify that identity.[3]

AUTOMATIC MANDATORY DISCLOSURES

Banks are required to report all suspicious transactions in a Suspicious Activity Report (SAR) to the federal government. A suspicious transaction includes those that are evidence of any "possible violations of any law..."[4] This extremely broad language of any "*possible*" violation places the burden on banks to err in favor of reporting more transactions than necessary, rather than fail to report a transaction that in some obscure way was related to a violation of a law. In addition, the threshold of which transactions are reportable is very low, just $5,000. Banks are prohibited from notifying the person about whom the SAR was created.[5]

Other reporting requirements include a requirement to report all international wire transfers.[6] All businesses, not just financial institutions, have to report any cash transaction exceeding $10,000 in a Currency Transaction Report (CTR).[7] This means that not only banks but a used car salesman, your dentist, and even your attorney[8] are

---

[3] 31 U.S.C. § 5138 (l)

[4] 31 Code of Federal Regulations (C.F.R.) 103.18 et seq.

[5] 31 U.S.C. § 5318 (g)

[6] 31 U.S.C. § 5318 (n)

[7] 31 U.S.C. § 5331

[8] United States v. Sapyta, 390 F. Supp. 2d 563 (W.D. Tex. 2005)

subject to this requirement. This law is not merely an obscure requirement, it has been the basis of prosecution of individuals.[9]

MANDATORY RESPONSE TO GOVERNMENT REQUESTS

Government agencies may request any personal information or account or transaction information held by any bank if they claim that you are reasonably suspected of engaging in terrorism or money laundering. Reasonable suspicion falls far short of the probable cause requirement of the Fourth Amendment needed to obtain a search warrant. Again, the bank is prohibited from notifying you if such a request has been made.[10]

Even if you are a customer of a foreign bank, if the bank has a branch in a US jurisdiction, government agencies claim the right to subpoena your records from the bank, even if the actual records are not held within the jurisdiction of the US.[11]

INDIVIDUAL REPORTING REQUIREMENTS

Individuals are required to report to the government if they carry more than $10,000 in cash across the border.[12] You are also required to file an FBAR if your aggregated foreign bank accounts are valued at greater than $10,000.[13] Even carrying $5 or more of pennies or nickels across the border, or shipping $100 or more, can subject you to both monetary fines and criminal prosecution.[14]

---

[9] United States v. $482,627.00 In U.S. Currency, 2005 BL 9847 (W.D. Tex. May 16, 2005)

[10] 31 C.F.R. 103.100

[11] 31 U.S.C. § 5318 (k) (3)

[12] 31 U.S.C. § 5332

[13] 31 C.F.R. 103.24

[14] 31 C.F.R. § 82.1

BANK PRIVACY THROUGH OFFSHORE BANKING

There are two main reasons why most people choose to hold assets outside of their home country. Tax savings and privacy. Tax issues are complex and will depend on factors unique to every individual including their risk tolerance, the length of time they want the tax protection, the kinds of assets they want to invest in, etc.

The other issue is privacy. Whether you wish to avoid annoying and time consuming spam and junk mail, to reduce your exposure to frivolous lawsuits, punitive damages, potential kidnapping, government persecution, or a host of other potential problems that come with a lack of privacy, you can benefit from the legal protection offered by other countries. This compliment to your tax strategy will help you maximize your benefit from offshore banking.

WHO SHOULD BANK OFFSHORE

Offshore and private banking is not only for the extremely wealthy, as many mistakenly believe. People of average means can benefit from having a private bank account offshore that enjoys significant privacy protection. Individuals who already have an international presence can also benefit greatly from having bank accounts in the most popular offshore jurisdictions because it can facilitate business. This is true whether or not you have ever traveled outside of your home country. If you do any business on the internet, such as buying, selling, marketing or some other online activity, the chances are very high that you are already dealing with customers, employees, independent contractors, merchants, customer service reps, or a host of other people who are scattered across the globe. Banking privately offshore reduces your exposure to currency controls, foreign exchange, political instability and systemic disruptions when you have an economic as well as electronic presence in some of the main centers of offshore economic activity.

People who are not super wealthy are also exposed to many of the same annoyances and potential legal dangers as wealthy individuals. Private banking in the right offshore jurisdiction can reduce this exposure. Although most people do not fit into this category, there are some that may even avoid blackmail, kidnapping and extortion because of the protection of bank secrets offered in offshore jurisdictions.

GENERAL EXPECTATIONS WHEN BANKING OFFSHORE ANYWHERE IN THE WORLD

If you are a criminal seeking to hide the profits of a criminal enterprise, you are out of luck. Neither I, nor any country in the world with an established banking system, are willing to help you achieve your nefarious purpose. All countries around the world will turn over at least the name, if not other details of a bank account if a foreign government presents sufficient evidence that the person is engaged in crime. A court order is usually required and the crimes often have to be more than petty crimes to allow disclosure of banking secrets.

What about numbered accounts? In years gone by you could simply deposit a large amount of cash in a bank in exchange for an account number, without showing any form of ID, and conduct transactions through that account. There are no numbered accounts that are completely anonymous anymore, at least in the formal banking system. Thus, you cannot hide from criminal investigation in another country by setting up an anonymous numbered account.

TAXES AND REPORTING REQUIREMENTS

This is not about tax evasion or tax fraud. All taxes should be reported and paid to the appropriate government. Failure to do so may expose you to civil, and possibly criminal liability in one or more countries. Suspicion of tax avoidance and tax fraud can lead to scrutiny of your domestic and international accounts that would not otherwise occur. Simply having a foreign bank account may trigger some reporting

requirements, like the FBAR requirement discussed above. Also, the holders must report their foreign accounts by completing boxes 7a and 7b on Form 1040 Schedule B.

TRANSFERS

Although simply having a bank account in a foreign jurisdiction increases the level of privacy of your assets significantly, opening your offshore account in the name of an entity such as a trust, corporation or other approved legal entity, will provide the greatest protection of your financial privacy. This is due in part to the reporting requirements when funds are transferred outside the borders of the US. All offshore countries mentioned here have many different entities which can be created to hold your accounts. Also, you can further increase your privacy protection by setting up a domestic trust, corporation or other entity to make the transfer of assets to your offshore account. Although you may ultimately be linked to the transaction, it can become a very long and difficult process, often requiring a subpoena, in order to penetrate your privacy. Where not prohibited by law, you may be able to take advantage of hawala transactions[15] [16] [17] in order to add funds to, or take funds out of, your offshore accounts without leaving records in the formal banking system.

RECOMMENDED OFFSHORE JURISDICTIONS

In order to compare offshore jurisdictions I look to the **legal** environment in the offshore jurisdiction, including the applicable laws, available legal entities, and other factors as well as to the **cultural** and other factors which effect the location as a viable offshore haven of bank privacy. The recommended jurisdictions to seek offshore bank privacy, starting with the best, are Panama, Switzerland, Lichtenstein, Nevis and Hong Kong.

---

[15] http://www.howtovanish.com/2009/09/modern-hawala/

[16] http://www.runtogold.com/2009/11/hawala-banking-and-currency-controls-part-i/

[17] http://www.runtogold.com/2009/11/hawala-banking-and-currency-controls-part-ii/

PANAMA

LEGAL ENVIRONMENT

The laws of Panama have been designed to invite foreign investment by protecting financial privacy. Panama offers statutory guarantees of financial privacy and confidentiality. There are both civil and criminal penalties for violating privacy laws in Panama, reducing the likelihood that a rogue bank employee will make disclosures of your records. Banks will still release records pursuant to criminal investigations for crimes such as money laundering and terrorism, but a Panamanian court order is required. Other legal benefits include relative financial stability and no currency controls. Following are outlines of some of the relevant specific provisions of law.

Article 74 of Cabinet Decree 238

This law prevents the Panama banking commission from conducting investigations on individual banking clients. Any information it uncovers while doing its regulatory operations cannot be revealed to any person or authority, unless subpoenaed by a Panamanian court order. Anyone found violating this order is subject to Article 101 which states:

"Any person who furnishes information in violation of this Cabinet Decree, or who violates any of the prohibitions established in it, for which no specific punishment is provided for, shall be subject to a monetary fine as determined by the Banking Commission, without prejudice to applicable criminal and civil liabilities."

Article 65 of Cabinet Decree 238

This Article regulates how the National Banking Commission gets access to banking information and documents. It states that the

Commission may only inspect the books of the bank *in general* and cannot single out individual bank accounts. This includes both deposits and securities held by the bank. Singling out an individual account requires a court order.

Panamanian Criminal Code, Article 168

Any person that is in legitimate possession of correspondence, records or documents which are not intended for public knowledge and discloses any of this information without proper authorization, is subject to prosecution, whenever such disclosure might inflict damage.

Panamanian Criminal Code, Article 170

"Any person that in the course of his occupation, employment, profession or activity obtains knowledge of confidential information that in the event of being made public could inflict damages, and such person discloses that information without the consent of the concerned party; or in the case that disclosure of such information were not necessary to safeguard a higher interest, shall be punishable by **imprisonment** of 10 months to 2 years **or a comparable fine**, and the inability to practice his occupation, employment, profession or activity for not more than 2 years."

TAX INFORMATION

Member nations of the Organization for Economic Cooperation and Development (OECD) signed a Memorandum of Understanding which committed them to sharing tax information with other signatory nations. Although many nations signed, Panama did not. In addition, tax evasion is not a locally recognized crime and therefore will not be the basis of a Panamanian court order to search your bank records. This is significant because simply having a Panamanian bank account will cause the US government to be suspicious of your tax compliance.

LEGAL ENTITIES

As with almost any country, corporations, LLCs and trusts can be formed which can then be used to open bank accounts. This structure contributes to the privacy protection of any individual, but Panama has an even stronger entity for privacy protection. Panama offers Bearer Share Corporations, which means anonymous corporate ownership. Upon formation, a corporation is required to provide some identifying information, but can then be transferred to another person or persons who remain anonymous. No public record of the transfer needs to be kept. To open and operate a bank account there will need to be two professional letters obtained, one from a bank and one from another professional. But these letters need to provide only limited amounts of information such as a reference from an accountant and bank that the business is engaged in legal activity.

Another excellent entity which is unique to Panama are Foundations. Conceptually they can be thought of as a trust owning a corporation. These are very popular as a vehicle for offshore banking and also provide excellent privacy protection.

CULTURAL AND OTHER FACTORS

Panama has often refused to follow US pressure. This makes Panama particularly attractive to protect financial privacy because the US government is the leading cause of the erosion of bank privacy domestically and abroad. The demonstrated ability and willingness to resist US pressure means that there is a strong likelihood that the legal environment will remain favorable for many years to come.

Panamanian banks are generally welcoming to foreign investors and impose fewer limitations on account holders than many other offshore countries such as Switzerland. They have much lower threshold deposit requirements so they can be ideal for smaller accounts. There are dozens of banks which offer offshore products and business is done in English or Spanish.

SWITZERLAND

LEGAL ENVIRONMENT

Historically, Switzerland has been known for its exceptional bank secrecy. Although the tradition dates back hundreds of years, it was in the 1930's that Switzerland codified bank secrecy into law. Now, Switzerland is the most famous protector of bank privacy and bank secrecy is even a part of their constitution.

Article 47 of the Swiss Federal Banking Act of 8 November 1934

1. Any [banker] who, ... has revealed a secret that was entrusted to him... will be punished by **imprisonment** ... or by a **fine**...
2. Violation of secrecy remains punishable even when the practice or employment has terminated or the holder of the secret no longer works in the banking industry.

Much like the Panamanian laws preventing disclosure, Swiss law can impose civil and criminal penalties for disclosure of financial information. Similar exceptions exist for criminal investigations of holders of Swiss accounts.

Beware of doing business with a branch of a Swiss bank located outside of Switzerland. The office will be subject to local banking regulation, rather than Swiss bank regulation. This means that there might be more reporting requirements and less privacy than would be found when conducting business within Switzerland itself.

TAX INFORMATION

Bank secrecy in Switzerland is on the decline. They are signatories to the recent OECD Memorandum of Understanding, meaning that Switzerland will begin to share more tax information with the US than

ever before. They will, however, require concrete evidence of tax evasion before disclosing any information. Information about foreign owners of Swiss accounts suspected of committing tax fraud in their home jurisdiction will also be provided if requested by a foreign government.

LEGAL ENTITIES

All forms of business entities recognizable in the US for privacy protection are also available in Switzerland. The use of LLC's, corporations and trusts are all available to open and hold bank accounts.

NUMBERED ACCOUNTS

The reality of numbered accounts is not in total harmony with the popular perception. Numbered accounts are not completely anonymous as is often believed. Upon opening a numbered account, the identity of the account holder is verified and then a record of that is kept within the bank, accessible only to a few of the highest bank officials. The name is removed from the regular transactions and is replaced with the number on the account, which can increase the privacy protection for the account holder significantly. Thus, everyday transactions can be carried out without any identification other than the number and a password, but the account itself is not completely anonymous. These accounts can be very expensive so they are probably not going to be worth while for most investors.

CULTURAL AND OTHER FACTORS

Switzerland is a country well known for its political stability, peacefulness and has cultivated a reputation as a respected banking culture. These qualities, apart from the privacy offered, make Switzerland a good place for opening an account. Recent disclosures of information by UBS and by a former employee of Julius Baer show that bank secrecy is becoming more vulnerable to pressure to disclose. This

is true, even though most Swiss are in favor of strong banking secrecy practices.

US CITIZENS

Banking options for US citizens are now more limited in Switzerland. Many banks refuse to do business with US citizens because of the new disclosure requirements of the OECD and the laws discussed above. In other instances, the cost of the account and minimum deposits have simply gone up as well as limitations placed on what kinds of accounts are available to US citizens. Minimum deposit requirements are usually about $250,000 for US citizens and the know your customer rules discussed above apply.

LICHENSTEIN

LEGAL ENVIRONMENT

Lichtenstein is very closely associated with Switzerland in its bank secrecy laws and culture. Thus, they too have very strict laws protecting bank secrecy.

Lichtenstein follows the know your customer rules. Information regarding balances and transactions, however, is kept private. Account holder names are disclosed only if there has been a clear violation of Lichtenstein law. The legal protection of bank secrecy also extends not only to bankers, but also to accountants, attorneys and trustees. Therefore, unlike many of the provisions of US law discussed above, there is very little risk of disclosure by these individuals in Lichtenstein.

TAX INFORMATION

Lichtenstein does not recognize tax evasion as a legitimate reason to disclose bank secrets. Thus, only for the more serious crime of tax fraud will information regarding an account in Lichtenstein be disclosed.

LEGAL ENTITIES

Lichtenstein recognizes most business forms available in other countries. An entity that is similar to, and was probably the model for the Panamanian Foundation, called a Stiftung, is available in Lichtenstein. Unique to Lichtenstein is what is known as an Anstalt (Establishment). These are noted for their extreme flexibility and the ability to provide anonymity for the founder and the beneficiaries. This anonymity is achieved by using an attorney or a trust company, to act as the founder. Banking business can be conducted through this entity which serves the function of a trust or corporation. The incorporation of an offshore Establishment in Liechtenstein is fairly easy and is similar to the creation of any other entity in Lichtenstein.

Other tools available to legal entities that protect privacy are the ability to hold corporate shares as a bearer, preventing disclosure of the identity of the holder. Numbered accounts similar to those in Switzerland are also available, usually only for very large accounts.

CULTURAL AND OTHER FACTORS

Liechtenstein has suffered similar corruption of bank secrecy law as the Swiss with bank officials being bribed by foreign nations to reveal details of accounts in Lichtenstein, although it cost a lot more for the Lichtenstein bank official to turn than the Swiss banker and the punishment imposed was more severe.

Lichtenstein, like all bank privacy havens, faces increasing pressure from other nations, most notably the US and Germany, to abolish bank secrecy and comply with foreign requests. The prince has stated that he

does not intend to change the bank secrecy laws any time soon. Even if he did, the country has the right to vote by referendum on it and would likely strike down any weakening of bank privacy laws. Like most Swiss citizens, Lichtenstein residents are in favor of their protection of bank secrecy.

NEVIS

LEGAL ENVIRONMENT

By statute, all banking information, and in fact all "confidential information" cannot be disclosed. Confidential information includes information relating to property, business transactions, and the relationship between individuals and professional institutions, like banks and attorneys. Similar to other countries listed, there are both criminal and civil penalties for violating this law. Disclosure is only permitted if it is for the investigation of a crime that is also a crime in Nevis.

LEGAL ENTITIES

The most common legal entities are recognized in Nevis including corporations, LLCs, trusts and International Business Companies (IBC). Nevis LLC membership may be determined by the operating agreement of the LLC, which is a private document not on file in any public registry or database, providing its members full secrecy.

CULTURAL AND OTHER FACTORS

Nevis is an English speaking country with stable fiscal policies, although most of the population lives in poverty. A unique aspect of Nevis is the ability to become a citizen of the country with relative ease. A $250,000 investment in local real estate and about $35,000 in fees will literally buy citizenship. This can provide you access to advantages not available to US citizens.

HONG KONG

LEGAL ENVIRONMENT

Financial Secrecy is a tradition in Hong Kong, but it is not a requirement of the law. If there has been fraud, banks will disclose information to a foreign government. In these cases, banks will still request a warrant before information will be disclosed. Like most other bank secrecy havens, Hong Kong follows know your customer rules and they have anti money laundering laws which apply to foreign bank account holders as well.

LEGAL ENTITIES

Hong Kong is a vibrant financial and international business center. Thus, all commonly recognized entities will also be recognized in Hong Kong. The requirements to form a foreign entity there are simple and relatively inexpensive. The beneficiary owners of any bank accounts, whether owned by a business entity or a trust, are required to be disclosed to open a bank account for the entity.

TAX INFORMATION

Hong Kong is not a party to any OECD tax treaties and therefore does not freely share information with foreign tax authorities. This is unlikely to change in the near future because Hong Kong has benefited greatly from the shift of foreign investment away from countries that formerly were tax havens and have now become parties to the OECD tax treaty.

CULTURAL AND OTHER FACTORS

Hong Kong's tradition as an international center for business and finance have created a good environment for quality banks to thrive there, giving you many options. Hong Kong's resistance to tax treaties and other US financial policies also bodes well for the future of financial privacy in Hong Kong.