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Bank Secrecy: Control vs. Individual Privacy

The Government submitted a draft bill before our nation's Congress to empower the Internal Revenue Service (SII in its Spanish acronym) with the authority to access the movements of bank accounts and those of other banking operations, of either natural or legal persons, to which effect it is required obtain judicial authority. This regulation would be applicable both to the fiscal control & supervision of domestic taxes, as well as to cooperation requests filed by foreign tax entities.

The need to approve this initiative was grounded in that it is a requirement for the country to join the Organization for Economic Co-operation and Development (OECD). It has to do with a tax control and supervision standard required by that organization that is broadly applied by its member countries, as a way to combat tax evasion and the movement of financial resources between each other, as well as of preventing that any one of them might become a haven for money not taxed in another.

The Government is attempting to amend an old legislation that states the best when it comes to guaranteeing a fundamental principle of any truly free society: the respect of individual privacy. Requiring that in order to release such protection at the banking level be necessarily and previously justified before a court of law, is not a manner of making fiscal control impossible or of hindering it, but rather, of requiring a basic standard to protect citizen's rights.

Nevertheless, throughout the project debate, a second reason emerged that had not been clearly stated from the outset: this measure would also contribute in combating domestic tax evasion, by an order of magnitude between 2 to 3 percentage points, equivalent to between US$ 600 and US$ 800 million a year[1].

Background for understanding the scope of this debate

In order to properly understand this draft bill, it is necessary to clarify certain points. On the one hand, the banking legislation[2] distinguishes between operations subject to secrecy and those under reservation. The former refers to bank deposits and borrowing; included among which are bank accounts, with respect of which the banks cannot release any information without the express authorization of

its property owner. The latter refers to other banking operations where the bank may release information to those who may accredit a legitimate interest in knowing it and provided that it is foreseeable that access to such information will not cause any damage to the client's resources. The SII is already entitled to obtain reserved information, arguing legitimate interest, which is none other than the fiscal control and supervision of the tax obligations incumbent upon that Service by law; nevertheless, they have never been able to obtain that which is protected by bank secrecy.

It should be added, however, that pursuant to that legislation, the courts of law may order the remittal of both types of information with respect to persons who are a party to or have been indicted in proceedings underway. Likewise, the Office of the Attorney General –in criminal investigations- may access the same, prior authorization issued by the jurisdictional guarantee judge.

From the foregoing it may be concluded that the SII cannot access the bank account movements of persons subject to simple tax obligation controls, not even with a court order, since judges may only order to exhibit the bank account movements of proceedings tried before that same court, and such fiscal control and supervision is a mere administrative process. An exception to this rule is if the SII should be in the process of investigating a tax crime –as explicitly established under art. 62 of the Tax Code- pursuant to which it suffices a simple decision adopted by the National SII Director to have access to such bank movements; a rule that is quite paradoxical, because the General Attorney's Office (the organ that is constitutionally in charge of investigating such crimes) requires a court order in order to carry out the same proceeding.

On the other hand, this initiative is not new: since the SII has long considered it indispensable to have access to bank accounts in order to fully perform its duties. Thus, in 2002 it promoted and managed Congress to approve a draft bill empowering it to request bank movements with a court order, but without the presence of the affected party. Nevertheless, the Constitutional Tribunal declared such bill to be unconstitutional, since it excluded the party affected from being heard, thereby infringing due process - one of the pillars of the "bilateral nature of hearings". Not hearing the party affected would only be admissible in crime investigations, but normal tax controls and supervision actions are not of such nature and they differ completely from them.

The Constitutional Tribunal's decision set a standard for looking into bank accounts for fiscal control and supervision objectives; the law could only approve such measure if performed with a court order and prior hearing of the party affected. In this sense, it is reasonable to state that the current rule authorizing the SII to look into bank accounts when investigating a tax crime without a court order, is indeed unconstitutional.

The draft bill

The government's initiative in comment authorizes the ordinary courts of justice to order examining operations subject to bank secrecy and reservation of persons involved in tax crime proceedings. An equal authority will be given to Tax and Customs Courts (nowadays being installed) when hearing a process involving violations penalized with penalties and deprivation of freedom[3]. This part of the draft bill is correct, because the SII authority of having direct access to bank accounts without a court order would thus cease.

It adds that in applying Chile's tax laws; namely, habitual fiscal control and supervision efforts not involving a tax crime –so as to comply with international cooperation treaties on this subject matter- the SII will have to subject itself to a two-step special proceeding in order to secure such information: in the first step, the SII must address the bank requesting the information; which, in turn, will have to communicate this circumstance to the client. If

the client is not opposed, the background information requested may be provided. Contrariwise, if the client is opposed, the information cannot be provided and the SII may only secure it via authority issued by the competent Tax or Customs Court. Such Court must then summon the affected party and, after hearing him/her, determine whether or not it authorizes the SII to access the banking information of the taxpayer in question. The court's resolution is appealable before the corresponding Court of Appeals.

The above-outlined procedure appears to fully meet the standard established by the Constitutional Tribunal; but, this is not so. In effect, first there is a "sweeping" procedure that alters the weight of proof: the taxpayer appears refusing and is taking before the court in order to explain why; and, second, intricately linked to the previous one, the draft bill does not establish a cause by virtue of which the SII should file a request for access, thereby justifying its auditing powers and its need to verify even in absence of any indication of tax evasion or undeclared income. In fact, the SII is officially of the opinion that such must be the interpretation of the draft bill; thus this should be an ordinary oversight and control tool –as enjoyed by all developed-country administrations- to which taxpayers should only be entitled to oppose with powerful reasons.

But no explanation is given as to which would such reasons be; because, if this was a normal pretension on the part of the SII justified by the mere need to control and supervise, and the taxpayer's privacy protection is not considered as a sufficient reason to oppose it, there would be no plausible reason whatsoever to ever oppose such audits. To the contrary, if the courts were to consider invoking the need for privacy as a sufficient reason to oppose such audits, they would never approve them.

In sum, this is a draft bill that bears the trappings of compliance with the constitutional requirement of having jurisdictional control and bilateral hearings; in practice, however, compliance with such conditions lacks content. Rather, the appropriate manner of complying with such constitutional requirement should be to require the SII to justify before the judge why its ordinary control and supervision powers –which are ample, indeed- are not enough and make it necessary to resort to an exceptional measure such as inroading into taxpayers' bank accounts; which are an expression of persons' private lives.

Fiscal revenues cannot be secured at just any cost; even less clear is to damage such objective because of such requirement. Quite to the contrary, it is possible for it to come out strengthened legitimacy-wise.

Less revenue if the judge steps in?

As stated above, one of the reasons adduced to justify accessing banking information is the positive impact that such practice would have on fiscal revenues. The argument goes that in certain sectors –typically the liberal professions or others- the persons who provide services elude issuing the corresponding professional services invoice, thus filing a lower income. Moreover, since the practical reality is that most of those persons who are their clients are part of the "cash economy" sector, service payments are made via bank checks or cards that, in turn, become banking operations of the service providers. Consequently, if the latter know in advance that their bank operations can be audited, they will feel compelled to issue professional service invoices and pay taxes on that income. According to the SII, the international experience demonstrates that this is indeed what happens. Therefore, by extrapolation, our country would benefit from higher revenue collection levels from the above-referred sums.

It is very likely that the foregoing is true; but, what has not yet been explained is why such deterrence would not exist when bank accounts are opened with a prior court order. In effect, ordinary audits today have no access and, if it were to be established under jurisdictional control, there would be a radically new situation and the deterring message would be equally disseminated. Now, banking operations can be audited –subject to court approval- and undeclared income can be spotted.

On the other hand, the Government has confronted criticism against this draft bill by proposing as safeguard that the request for banking information be only submitted by the National SII Director[4]. Naturally, this implies a significant practical restriction in the use of such power, but it also behooves those officers in charge of the audit to diligently prepare and ground the case before submitting it to their superiors, until reaching the top SII management level. If such case was meaningful to the National SII Director –as well as to other mid-level SII management echelons called upon for their stamp of approval, then, such case should also be meaningful to a judge. Why would it then be a problem to secure the approval of a judge? It would appear as though there is a determination to retain some degree of administrative discretion; which is what judicial controls are precisely called upon to moderate.

The OECD requirements

Unquestionably, the trend among OECD member countries –mainly those that belong to the developed world- is to empower their tax administrations with sufficient powers to investigate and track down personal and corporate banking operations. It is also unquestionable that joining such organization would be very significant for Chile. But the question is, at which cost are we willing to do it; if at the cost of the private lives of citizens, then, it appears very questionable indeed. To expand the control power of the State over its citizens entails major risks for freedom; the basis of coexistence and democracy. Whatever other countries do is not sufficient reason for us to follow suit, absent the reasons to justify such conduct. Moreover, it would not be surprising at all if countries with such long libertarian traditions, like the United States of America (which felt forced to abandon its own founding libertarian logic in this regard after the “S-11” attempts) would reverse such course of behavior.

The topic of access to bank accounts in particular and banking operations in general, entails very deep expressions of our private lives. Through them -in today’s world- the most elementary acts of private life are materialized, ranging from consumer decisions, acts of altruism or solidarity, to political preferences, etc., which we do not always wish to make public. Furthermore, knowing them may open the gates for practices of extortion or pressures of the most varied nature. Many of such bank movements may motivate tax challenges because they often have various meanings and scopes, and the SII objections will make it necessary to come out will all kinds of explanations which may be misinterpreted or systematically questioned, damaging persons and causing pervasive and continuous fear that may inhibit our acts as free human beings. Culturally, the safeguarding of banking operations has been considered in Chile as an expression of private life that deserves to be protected, because the so-called “banking secrecy” has long been established in our legislation, bearing in mind that in the past our society has not been always respectful of citizen’s rights.

Because of this, it is not up to the Government to just bow before the requirements of that international organization; it must also represent before it its own citizens’ legitimate position. In this sense, one must keep in mind that we are not here suggesting that banking operations remain unaudited or that tax control cooperation requests from other countries should not be attended to; but rather, that all this be performed in line with a level of protection (i.e. jurisdictional control) that no civilized

nation should question and that stems directly from our fundamental institutions.

Furthermore, neither does the OECD accept unlimited requests between countries; quite to the contrary, it mandates to restrict petitions to cases that investigate concrete situations, expressly excluding the so-called "fishing expeditions"; with random information requests to see just whatever comes out of them.

It is unthinkable for the OECD to oppose the application of that same justification standard to our country's own domestic controls; if so, foreigners would stand on a privileged position with respect to the standards to be applied to those who live in the nation's territory.

Neither can a country's membership to an international organization –regardless of its prestige- be used as basis to exempt the protection that the State must provide individual persons.

Finally, it is necessary to remember that Chile is no financial haven for capitals of questionable origin amenable to hiding resources or illicit goods or to eluding other countries' controls. All capitals flowing into the country are subject to stringent registration procedures and foreign exchange controls; which are also applicable to capital repatriations and profit remittals. Those examples that refer to concessions that certain countries have been required to make on this matter, belong precisely to cases that fit that category; consequently, our country should be treated differently.

Conclusions

The Government is attempting to approve changing an old legislation that is the best in terms of protecting a fundamental principle of all truly free societies: the respect to individual privacy. Requiring that in order to remove such protection at the banking level such procedure be previously justified before a court of law, is not a way of making impossible or hindering the necessary oversight and control of tax obligations, but rather, the requirement of a basic protection standard for citizens' rights.

Tax revenues cannot be secured at just any cost; even more questionable would be to damage that objective because of such an attempt. To the contrary, it is quite possible that such objective might be strengthened precisely because of its legitimacy.

Joining an international organization -no matter how prestigious it might be- cannot serve as basis to exempt the State from its duty to protect all persons.

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[1] El Mercurio, June 25, 2005, page B 2.

[2] Art. 154 of the General Law on Banks, included in Decree Law (DFL in its Spanish acronym) N° 3 issued by the Ministry of Finance in the year 1997.

[3] The reference made to violations sanctioned with prison penalties (only applicable to crimes) is questionable and must be understood to refer to those cases in which, since such violation is additionally sanctioned with prison penalties, the National SII Director should then decide not to prosecute criminal liabilities but merely administrative ones; because criminal prosecutions are of the exclusive jurisdiction of the Attorney General's Office and the resolution of the case is of the jurisdiction of the Guarantee and Oral Courts (on criminal matters), never of Tax or Customs Tribunals.

[4] The original draft bill does not establish this restriction; however, it has been committed by the Government; therefore, it is expected to be materialized during its legislative debate.