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Buying FATCA Compliance: Overcoming Holdout Incentives to Prevent International Tax Arbitrage

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COMMENT

BUYING FATCA COMPLIANCE: OVERCOMING HOLDOUT INCENTIVES TO PREVENT INTERNATIONAL TAX ARBITRAGE

Marc D. Shepsman *

INTRODUCTION

The United States is at war with tax evaders.[1] A 2008 Congressional Report estimated that the United States loses close to US$100 billion in tax revenues annually due to offshore tax evasion.[2] Policy makers often blame tax havens for this "staggering" statistic, pointing to the legal systems of tax haven countries that provide tax evaders with the means to avoid detection by US authorities.[3] According to the Organization for Economic Cooperation and Development ("OECD"),

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1. *See, e.g.*, Charles Rettig & Dennis Perez, *Tax Tips: The IRS 2011 Offshore Voluntary Disclosure Initiative*, L.A. LAW., June 2011, at 9, 9 (noting that the Internal Revenue Service ("IRS") has been "waging a fierce battle" against taxpayers who fail to report earnings on their non-US assets); *see also* Daniel J. Mitchell, *In Praise of Tax Havens*, FREEMAN, July–Aug. 2009, at 23, 23 (asserting that President Obama declared a war on Americans who shelter their money in overseas, low tax jurisdictions).

2. *See* STAFF OF PERMANENT SUBCOMM. ON INVESTIGATIONS OF THE S. COMM. ON HOMELAND SEC. AND GOVERNMENTAL AFFAIRS, 110TH CONG., REP. ON DIVIDEND TAX ABUSE: HOW OFFSHORE ENTITIES DODGE TAXES ON U.S. STOCK DIVIDENDS 1 (Comm. Print 2008) (deriving the tax gap from studies conducted by a number of tax experts); *see also* David Spencer, *Cross-Border Taxation and Bretton Woods II (Part 3)*, J. INT'L TAX'N, July 2009, at 44, 47 (summarizing the Committee on Homeland Security and Governmental Affairs' investigatory findings that offshore tax abuse has cost the United States billions of dollars, and that offshore hedge funds are "frequent participants" in these abusive tax practices).

3. *See* STAFF OF PERMANENT SUBCOMM. ON INVESTIGATIONS OF THE S. COMM. ON HOMELAND SEC. AND GOVERNMENTAL AFFAIRS, 109TH CONG., REP. ON TAX HAVEN ABUSES: THE ENABLERS, THE TOOLS AND SECRECY 1 (Comm. Print 2006) [hereinafter HAVEN ABUSE] (noting that financial professionals utilize bank secrecy laws and limited disclosure requirements to "hide assets and transactions" from US agencies); *see also* INTERNAL REVENUE SERV., DEPT. OF TREASURY, REDUCING THE FEDERAL TAX GAP: A REPORT ON IMPROVING VOLUNTARY COMPLIANCE 35–36 (2007), *available at* 2007 WL 2295615 (describing Internal Revenue Service ("IRS") efforts to reduce the tax gap by allocating resources towards identifying taxpayers who engage in offshore activity).

globalization has opened up new channels for individuals and businesses to minimize and avoid taxes.[4] Tax havens, generally nations that lower tax liabilities, can take advantage of this phenomenon by developing tax policies aimed primarily at attracting "geographically mobile capital."[5] The reduction of non-tax trade barriers, an element of globalization, has further exacerbated the effect that domestic tax policies can have on international economies.[6] Consequently, tax havens hold nearly US$1.5 trillion in US assets.[7] As the enormous tax gap suggests, the United States has thus far found itself on the losing side of this war.[8]

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4. *See* ORG. FOR ECON. CO-OPERATION & DEV., HARMFUL TAX COMPETITION: AN EMERGING ISSUE 14 (1998) [hereinafter HARMFUL TAX COMPETITION], *available at* http://www.oecd.org/tax/transparency/44430243.pdf (attributing the rise of exploitative tax practices to the combination of technological innovation and increased global competition); *see also* Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1575–76 (2000) (describing technological innovations such as electronic transfer of funds as contributing to international tax competition).

5. *See* HARMFUL TAX COMPETITION, *supra* note 4, at 14 (describing the new opportunities that globalization affords tax havens to develop internal policies aimed at attracting external capital); *see also* Avi-Yonah, *supra* note 4, at 1576 (explaining that, because capital is much more mobile than labor, countries compete for both portfolio and direct investment by lowering the taxable income earned by non-residents).

6. *See* HARMFUL TAX COMPETITION, *supra* note 4, at 14 (finding that the tax policies of one country are now "more likely" to have a direct consequence on other economies); *see also* Tsilly Dagan, *The Tax Treaties Myth*, 32 N.Y.U. J. INT'L L. & POL. 939, 949 (2000) (arguing that one country's policies directly affect the outcome of another country's policies, "and vice versa"). For the interplay between non-tax trade barrier reduction and domestic tax policies, see, for example, Marrakesh Agreement Establishing the World Trade Organization pmbl, Apr. 15, 1994, 1867 U.N.T.S. 154 (declaring that positive economic effects of globalization could be obtained through "reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade").

7. *See* HAVEN ABUSE, *supra* note 3, at 2 (reporting the current estimation of US assets held by tax havens); *see also* John D. McKinnon, *Tax Justice Network: Wealth Held in Tax Havens Skyrockets*, WALL ST. J. (July 22, 2012, 5:05 AM), http://blogs.wsj.com/washwire/2012/07/22/tax-justice-network-wealth-held-in-tax-havens-skyrockets/ (detailing that unreported wealth held in tax havens could be as high as US$32 trillion).

8. *See* I.R.S. News Release IR-2012-04 (Jan. 6, 2012) (discussing the tax gap estimates for tax year 2006, estimating a voluntary compliance rate of 83.1 per cent, with underreporting of income as the biggest contributing factor to the tax gap); *see also* Nicholas Shaxson, *The Truth About Tax Havens: Part 2*, GUARDIAN (U.K.), Jan. 9, 2011, at 22 (arguing that the impression that offshore tax systems have been dismantled is contrary to what actually happened).

More recently, the 2008 financial crisis put pressure on increasingly indebted governments to refocus their attention on the harmful effects that tax havens and tax evasion have on their national treasuries.[9] The United States, like many other nations, relies on personal income and consumption taxes as a major source of its tax revenues.[10] As a result, the most recent financial crisis substantially decreased US tax revenues because both earnings and consumption dropped.[11] Further, the Troubled Asset Relief Program ("TARP") and other federal government bailouts created additional spending commitments that further widened the disparity between government spending and revenue.[12]

In response to this revenue shortcoming, and drawing upon the lessons from the 2008 UBS AG tax evasion scandal, in which UBS admitted to fraud and conspiracy in exchange for a US$780 million fine, Congress enacted the Foreign Account Tax Compliance Act ("FATCA"), as part of the comprehensive

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9. *See* JAMES K. JACKSON, CONG. RESEARCH SERV., R40114, THE OECD INITIATIVE ON TAX HAVENS 1 (2009) (arguing that governments have been targeting tax havens to increase revenues because of the financial crisis); *see also* John Brondolo, *Collecting Taxes During an Economic Crisis: Challenges and Policy Options*, IMF STAFF POSITION NOTE (Int'l Monetary Fund, Washington, D.C.), July 14, 2009, paras. 54–57, *available at* http://www.imf.org/external/pubs/ft/spn/2009/spn0917.pdf (noting that tax agencies are strengthening their enforcement efforts as a result of the financial crisis, and that these concerns have intensified with deteriorating national treasuries).

10. *See, e.g.*, Allison Christians, *Taxation in a Time of Crisis: Policy Leadership from the OECD to the G20*, 5 NW. J. L. & SOC. POL'Y 19, 21 (2010) (describing the shift towards taxes on personal income as opposed to capital taxes); *see also* U.S. GOV'T REVENUE BREAKDOWN, http://www.usgovernmentrevenue.com/breakdown (last visited Jan. 24, 2013) (breaking down the sources of US revenues by category).

11. *See* Christians, *supra* note 10, at 21 (noting that economic crises directly affect earnings and therefore consumption levels); *see also* Jaewoo Lee, Pau Rabanal & Damiano Sandri, *U.S. Consumption After the 2008 Crisis*, IMF STAFF POSITION NOTE (Int'l Monetary Fund, Washington, D.C.), Jan. 15, 2010, paras. 7–8, *available at* http://www.imf.org/external/pubs/ft/spn/2010/spn1001.pdf (reporting a three percent decline in US household consumption between 2008 and 2009, coupled with a steep decline in wealth).

12. *See* Emergency Economic Stabilization Act of 2008, 12 U.S.C. §§ 5211–5241 (2012) [hereinafter EESA] (creating The Troubled Asset Relief Program ("TARP") in Title I of Pub. L. 110-343); Christians, *supra* note 11, at 21 (explaining that governments have been forced to meet the additional revenue needs largely through borrowing); *see generally* Brent Horton & Jack Vrablik, *The Troubled Asset Relief Program (TARP): Uses and Abuses*, BANKING & FIN. SERVS. POL'Y REP., Aug. 2010, at 24 (2010) (describing the number of ways in which the TARP funds have been used).

Hiring Incentives to Restore Employment ("HIRE") Act.[13] President Obama signed the bill into law on March 18, 2010, as a potentially forceful solution to the type of offshore tax evasion brought to light by the UBS scandal.[14] FATCA's stated purpose is to detect and deter offshore tax evasion by requiring all Foreign Financial Institutions ("FFIs"), non-US trusts, and non-US corporations to identify and annually report information to the Internal Revenue Service ("IRS") about their US accountholders.[15] The overseas entities that do not comply with FATCA's provisions face a thirty percent withholding tax on all US-sourced withholdable payments (i.e., certain types of payments generally fixed or determinable, annual or periodical ("FDAP")) to a non-US person or business entity.[16] As US Senator Carl Levin pointed out, some financial institutions might choose to forego all US investments rather than enter into a FATCA compliance agreement.[17] Institutions that do not forego their US investments, though, will be subject to FATCA's new, and more complicated, disclosure requirements.[18]

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13. *See* Hiring Incentives to Restore Employment Act, Pub. L. No. 111–147, 124 Stat. 71 (2010) (codified as amended in scattered sections of 26 U.S.C.). The Foreign Account Tax Compliance Act ("FATCA") constitutes Title V of the Hiring Incentives to Restore Employment ("HIRE") Act, and acts as a revenue-generating offset provision. 26 U.S.C. §§ 1471–1474. *See* Brian Kindle, *FATCA May Identify Tax Cheats, but its Dragnet for Financial Criminals May Produce an Even Bigger Yield*, ASS'N CERTIFIED FIN. CRIME SPECIALISTS (Mar. 1, 2012), http://www.acfcs.org/fatca-may-identify-tax-cheats-but-its-dragnet-for-financial-criminals-may-produce-an-even-bigger-yield/ (reporting that the "groundbreaking" UBS settlement inspired the FATCA legislation).

14. *See* 155 CONG. REC. S10778-01 (daily ed. Oct. 27, 2009) (statement of Sen. Max Baucus) (exclaiming that FATCA represented a turning point in putting an end to offshore tax evasion); *see also* Nick Mathiason, *Tax Scandal Leaves Swiss Giant Reeling*, OBSERVER (U.K.), June 28, 2008, at 4 (describing how UBS systematically helped wealthy US clients evade US taxes).

15. See I.R.C. §§ 1471–1474 (2006) for the specific statutory provisions to which FATCA applies. *See also* 155 CONG. REC. S10778-01 (announcing that FATCA strengthens the ability of the United States to detect tax evasion).

16. *See* I.R.C. § 1441(b) (addressing withholdable payments generally); *see generally* David Spencer, *The Foreign Account Tax Compliance Act of 2009*, 26 INT'L ENFORCEMENT L. REP. 28 (2010) (summarizing the provisions of FATCA).

17. *See* 157 CONG. REC. S4518-01 (daily ed. July 12, 2011) (statement of Sen. Carl Levin) (maintaining that "U.S. banks have had it with foreign banks using secrecy to attract U.S. clients"); *see also* Spencer, *supra* note 16, at 28 (providing that FATCA applies to all Foreign Financial Institutions ("FFIs") that derive US-source income).

18. *See* I.R.C. §§ 1471–1474; *see also* 157 CONG. REC. S4518-01, (arguing that the US has a right to enforce its tax laws against those who do business in the United States).

Recently the IRS announced that it would modify its proposed regulations and extend the implementation of FATCA to January 1, 2014, to "reduce administrative burden."[19] Although this extension was certainly a welcome reprieve, FATCA raises a number of concerns in its critical purpose of attempting to enforce US tax laws and solve offshore tax evasion.[20] According to some financial analysts and commentators, compliance with FATCA's due diligence requirements poses an immense administrative burden upon compliant FFIs.[21] This burden could be so great as to potentially drive future investment away from the United States, which would then likely fail to generate the revenue anticipated.[22]

This Comment examines the harmful consequences that the implementation of FATCA might have, particularly as this legislation could affect the ability of the United States to induce tax haven compliance in the future. Tax evasion thrives on information asymmetry, and the current bilateral and

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19. I.R.S. Announcement 2012-42, I.R.B. 2012-47 (Nov. 19, 2012), *available at* http://www.irs.gov/irb/2012-47_IRB/ar09.html (noting that the IRS received comments identifying practical concerns about the implementation of FATCA that the IRS had deemed warranted an extension to decrease administrative burdens); *see* Samuel Rubenfeld, *Experts Laud Extra Time to Implement FATCA Compliance*, WALL ST. J. (Jan. 22, 2013, 5:42 PM), http://blogs.wsj.com/corruption-currents/2013/01/22/experts-laud-extra-time-to-implement-fatca-compliance/ (reporting that the IRS gave FFIs until December 31, 2013, to modify their compliance systems).

20. *See* 155 CONG. REC. S10778-01 (daily ed. Oct. 27, 2009) (statement of Sen. Max Baucus) (claiming that FATCA gives the IRS "powerful tools to find US taxpayers who are hiding their money in offshore accounts"); *see also* Marie T. Yates et al., *Death of Information-Exchange Agreements? Part 3*, J. INT'L TAX'N, Apr. 2011, at 48, 55 (arguing that FATCA eases the government's burden in prosecuting offshore tax evasion).

21. *See* Regulations Relating to Information Reporting by Foreign Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities, 78 Fed. Reg. 5874 (Jan. 28, 2013) (outlining the final regulations of FATCA); *see also* Kindle, *supra* note 13 (explaining that some FFIs are taking an "alternative approach" to compliance by simply dropping their US customers).

22. *See* Andrew Quinlan, *With Final FATCA Rules Released, It's Now or Never*, CTR. FOR FREEDOM & PROSPERITY (Jan. 24, 2013), http://freedomandprosperity.org/2013/blog/with-final-fatca-rules-released-its-now-or-never/(arguing that, in addition to requiring compliant FFIs to divert billions towards compliance, the Act would ultimately drive investment out of the US economy); *see also* Lisa Smith, *FATCA Costs May Drive Wealth Managers Out of Business*, IEXPATS (July 28, 2012), http://www.iexpats.com/2012/07/fatca-costs-may-drive-wealth-managers-out-of-business/ (maintaining that the costs of compliance could put smaller investment firms out of business).

multilateral exchange agreements have proven generally incapable of overcoming this problem.[23] Part I provides background information on tax havens and the relevant international agreements that the United States has used to curb illicit tax practices. Part II explores the conflict created by the UBS scandal and Congress' legislative reaction to the overwhelmingly large federal tax gap through the enactment of FATCA. It further analyzes the effect that FATCA might have on future tax treaties between the United States and other countries. Part III concludes by arguing that, because bilateral treaties incentivize holdouts by non-signatory nations, FATCA encourages tax arbitrage and capital flight towards these non-signatory nations. It concludes that the United States can overcome this holdout incentive through the use of tax flight bounty sharing treaties that would induce tax haven participation in international information exchange, increase taxpayer voluntary compliance, and minimize tax arbitrage.

I. *BACKGROUND*

Part I examines the role that tax havens have played in shaping US tax policy because offshore tax evasion is deeply intertwined with the existence of tax havens. Part I.A describes the characteristics of a tax haven and how technological innovation and globalization have heightened the role tax havens play in the international tax system. Part I.B then examines the various international agreements entered into by the United States with respect to enforcing its tax laws. Finally, Part I.C details the UBS scandal so as to put FATCA's enactment into a broader perspective.

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23. *See* Victor Thuronyi, *International Tax Cooperation and a Multilateral Treaty*, 26 BROOK. J. INT'L L. 1641, 1646 (2001) (arguing that the existing international tax system under bilateral treaties favors "private actors—both multinational companies and wealthy individuals—who can take advantage of the lack of coordination to minimize the taxes they pay"); *see also* Adam H. Rosenzweig, *Harnessing the Costs of International Tax Arbitrage*, 26 VA. TAX REV. 555, 607–09 (2007) [hereinafter Rosenzweig, *International Arbitrage*] (acknowledging that multinational cooperation could potentially overcome the problems of tax arbitrage, but that countries have "little incentive to engage in bilateral or multilateral cooperation, resulting in an equilibrium of non-cooperation").

A. *Tax Havens and Harmful Tax Competition*

There is no single, unambiguous definition of a "tax haven."[24] In a 1998 report on harmful tax competition ("1998 Report"), however, the OECD developed a number of factors to identify a tax haven's key features.[25] Among these factors, the OECD determined that the necessary starting point in identifying a tax haven was evaluating whether the country imposes no or nominal taxes, and offers itself, or is generally known as, a place that non-residents use to evade taxes in their home countries.[26] If this first inquiry is answered in the affirmative, three more key factors can be used to confirm the existence of a tax haven: (a) lack of effective information exchange; (b) lack of transparency; and (c) lack of substantial activities.[27]

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24. *See* TAX JUSTICE NETWORK, IDENTIFYING TAX HAVENS AND OFFSHORE FINANCIAL CENTRES 7 (2007), *available at* http://www.taxjustice.net/cms/upload/pdf/Identifying_Tax_Havens_Jul_07.pdf (noting that while no single definition exists, some criteria appear in more than one definition); Michael Littlewood, *Tax Competition: Harmful to Whom?*, 26 MICH. J. INT'L L. 411, 421 (2004) (explaining that the Organisation for Economic Co-operation and Development ("OECD") did not attempt to define the "tax havens" it sought to eliminate).

25. *See* HARMFUL TAX COMPETITION, *supra* note 4, at 19 (reporting that the OECD focused on identifying factors that enabled havens to attract mobile, financial activities); *see also* Littlewood, *supra* note 24, at 422 (clarifying that, despite the OECD's lack of a proposed definition, the OECD devoted substantial portions of the 1998 Report to answer the question of how one might be recognized).

26. *See* HARMFUL TAX COMPETITION, *supra* note 4, at 22 (maintaining that tax havens offer ways to minimize taxes); *see also* Thuronyi, *supra* note 23, at 1647 (explaining that many countries intentionally create favorable tax regimes in which corporations take advantage of tax disparities to minimize their own tax burdens).

27. *See* HARMFUL TAX COMPETITION, *supra* note 4, at 22–24 (explaining that non-transparent administrative practices facilitate tax evasion because external nations often cannot access the information); *see also* ORG. FOR ECON. CO-OPERATION AND DEV., THE OECD'S PROJECT ON HARMFUL TAX PRACTICES: THE 2001 PROGRESS REPORT 10 (2001) [hereinafter 2001 PROGRESS REPORT], *available at* http://www.oecd.org/ctp/harmful/2664438.pdf (acknowledging that determination of the fourth factor would be difficult, and interpreting the lack of substantial local activities requirement to mean instead that the inquirer should look to see if there are factors that discourage substantial domestic activities). More recently, however, and due to concerns expressed by member countries and tax havens as to its application, the OECD's Committee on Fiscal Affairs downgraded the significance of this fourth criterion. *See id.* at 9–10 (noting that, in light of discussions with various jurisdictions, the Committee on Fiscal Affairs determined that this factor would no longer be used to determine tax haven's cooperativeness).

The OECD is an international, intergovernmental organization comprised of thirty-four member countries dedicated to the development and analysis of social and economic policy.[28] Although the OECD has been tackling the issue of tax havens since its 1961 formation, it was not until 1996 that the Organization's Ministers called upon the OECD "to develop measures to counter the distorting effects of harmful tax competition."[29] In the 1998 Report, the OECD demonstrated particular interest in studying how regimes that engaged in harmful competition affected geographically mobile capital, eroded foreign tax bases, and distorted trade and investment patterns.[30] With the constant acceleration of globalization, the OECD sought to promote open, multilateral trading systems and recommend policy adjustments to level the taxation playing field that it deemed essential to continued global economic growth.[31]

By many scholarly definitions, the United States is perhaps the largest tax haven in the world.[32] Non-US citizens are

28. *See* JACKSON, *supra* note 9, at 1 (providing the background and organization structure of the OECD); *Members and Partners*, ORG. FOR ECON. CO-OPERATION AND DEV., http://www.oecd.org/about/membersandpartners/ (last visited July 26, 2013) (enumerating the complete list of member countries); *see also What We Do and How*, ORG. FOR ECON. CO-OPERATION AND DEV., http://www.oecd.org/about/whatwedoandhow/ (last visited July 26, 2013) (describing the OECD's mission and objectives).

29. *See* HARMFUL TAX COMPETITION, *supra* note 4, at 3 (quoting Communique of the Meeting of the Council at Ministerial Level, Org. for Econ. Co-operation and Dev. (May 21–22, 1996), *available at* http://www.g7.utoronto.ca/oecd/oecd96.htm) (describing the motive behind commissioning the 1998 Report); *see also* JACKSON, *supra* note 9, at 5 (outlining the various OECD conventions on tax havens, and noting that the OECD updated its tax convention to reflect "the liberalization in the capital markets and the globalization in business activities").

30. *See* HARMFUL TAX COMPETITION, *supra* note 4, at 8 (identifying the objectives of the commissioned report so that the OECD could better strengthen and improve international tax policy in the future); *see also* Kimberly Carlson, *When Cows Have Wings: An Analysis of the OECD's Tax Haven Work as it Relates to Globalization, Sovereignty and Privacy*, 35 J. MARSHALL L. REV. 163, 165 (2002) (reporting that the OECD's main concern was counteracting harmful tax competition with respect to geographically mobile capital in contrast to, for example, infrastructure investment).

31. *See* HARMFUL TAX COMPETITION, *supra* note 4, at 9 (enumerating the proposals that the 1998 Report addresses); *see also* Carlson, *supra* note 30, at 173–74 (outlining the proposals set out by the OECD to further its objectives in promoting "fair" competition).

32. *See* Daniel J. Mitchell, *Why Tax havens Are a Blessing*, FOREIGN POL'Y (Mar. 17, 2008), http://www.foreignpolicy.com/articles/2008/03/16/why_tax_havens_are_a_blessing (explaining that the United States could be considered "the world's largest tax haven" and has benefitted tremendously from foreign investment); Bruce Zagaris,

generally not taxed on, inter alia, capital gains, and thus collect income without being subject to taxation.[33] To create policy aimed at a tax haven, it is necessary first to determine exactly which countries are tax havens.[34] Developing a workable definition of a tax haven is fraught with difficulty because the definition depends almost entirely upon a baseline with which to compare it.[35]

Notwithstanding the difficulties in crafting an accurate definition, the 1998 Report maintains that jurisdictions intentionally seeking to redirect capital and financial flows away from other jurisdictions are harmful in that they: (1) distort financial flows; (2) undermine the integrity and fairness of tax structures; (3) discourage compliance by all taxpayers; (4) reshape a country's desired level of taxes and expenditure; (5) shift the tax burden on less mobile tax bases; and (6) increase the administrative costs and compliance burdens on tax authorities.[36] According to the OECD, a tax practice that has substantial spillover effects as to be "poaching other countries' tax bases" would undoubtedly be regarded as "harmful."[37] Many

World Bank Accepts Norway's Plan to Target Tax Havens, 23 INT'L ENFORCEMENT L. REP. 425, 425 (2007) (remarking that despite focus on traditional tax havens, the United States and United Kingdom are the largest tax havens in the world).

33. *See* I.R.C. § 871(a) (2012). Non-resident aliens present in the United States for more than 183 days, however, are taxed like US citizens. *See* § 7701(b)(3)(A)(ii).

34. *See* Carlson, *supra* note 30, at 176 (arguing that by encouraging defensive measures against countries with no or very low effective tax rates, the OECD is dictating that these levels are "inappropriate"); *see also* Mykola Orlov, *The Concept of Tax Haven: A Legal Analysis*, 32 INTERTAX 95, 102 (2004) ("The importance of coming up with a definition arose in the domestic practices of the developed countries which needed to restrict the abuse of tax haven jurisdictions and practices by their taxpayers.").

35. *See* J.C. Sharman & Gregory Rawlings, *National Tax Blacklists: A Comparative Analysis*, J. INT'L TAX'N, Sept. 2006, at 38, 41 (noting that it is "extremely difficult" to define a tax haven); *see also* J. Mukadi Ngoy, *The Paradox of Tax Havens: Consequences of the Subjective Approach*, J. INT'L TAX'N, Jan. 2001, at 34, 38 (noting that without one, unanimous definition, the "quintessential relativity of the concept seems to be its main feature").

36. *See* HARMFUL TAX COMPETITION, *supra* note 4, at 16 (enumerating the potential harmful effects that the internal tax policies of a tax haven may have externally); *see also* Carlson, *supra* note 30, at 174–75 (conveying the OECD's argument that the continued existence of tax havens has substantial repercussions on other governments' abilities to finance their social programs due to a shrunken tax base).

37. *See* HARMFUL TAX COMPETITION, *supra* note 4, at 16 (clarifying that, in the absence of all of the aforementioned factors, an internal tax policy that poaches money from other countries must be harmful); *see also* Thuronyi, *supra* note 23, at 1647

scholars, however, maintain that tax havens help keep tax rates down by pressuring politicians in high-tax nations to lower tax rates.[38] The presence of tax havens can, and do, force high-tax countries like the United States to adopt tax regimes that focus on favorable in-bound investments, which in turn contributes to a nation's prosperity.[39]

B. *International Tax Treaties and Agreements*

The United States has confronted some of the problems that tax havens present through the use of Double Taxation Agreements ("DTAs"), Mutual Legal Assistance Treaties ("MLATs"), and Tax Information Exchange Agreements ("TIEAs").[40] It has long recognized that it is impossible to fully enforce domestic tax law without the help of these agreements.[41] According to the IRS, tax treaties serve three main functions: (1) avoiding the double taxation of income, property or property transfers; (2) avoiding discriminatory tax treatment of residents of the signatory nation; and (3) permitting reciprocal

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(noting that tax competition to attract external investment undermines the tax bases of these external nations).

38. *See* ALOISIO ALMEIDA, FORD SCH. PUB. POLICY, TAX HAVENS: AN ANALYSIS OF THE OECD WITH POLICY RECOMMENDATIONS § 2.2.1 (2004), *available at* http://www.receita.fazenda.gov.br/Publico/estudotributarios/TrabAcademicos/Textos/AloisioTaxHavens.pdf ("For some people, tax havens help keep rates down and, therefore, are legitimate tax competitors."); *see also* Mitchell, *supra* note 1, at 24–25 (arguing that tax havens promote good policy and better governance, citing double taxation treaties as one example of the positive effects of tax competition).

39. *See* Carlson, *supra* note 30, at 175 n.50 (pointing to the positive effects that tax havens may have in disciplining governments against adopting "confiscatory" tax regimes due to competition); *see also* Mitchell, *supra* note 1, at 25 (noting that most high-tax countries paradoxically have more favorable tax policies for in-bound rather than internal investment).

40. See *United States Income Tax Treaties - A to Z*, INTERNAL REVENUE SERV., http://www.irs.gov/Businesses/International-Businesses/United-States-Income-Tax-Treaties—A-to-Z (last visited July 27, 2013), for a list of current income tax treaties. See also *Treasuries and TIEAs*, U.S. DEP'T TREASURY, http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/treaties.aspx (last visited July 27, 2013), for recent tax treaties and Tax Information Exchange Agreements ("TIEAs") that the United States maintains.

41. *See* Dennis D. Curtin, *Exchange of Information Under the United States Income Tax Treaties*, 12 BROOK. J. INT'L L. 35, 35 (1986) (noting that bilateral tax treaties have grown in importance with the widespread international tax avoidance and evasion, concomitant with the growth of international trade); *see also Treaties in Force*, U.S. DEP'T ST., http://www.state.gov/documents/organization/83046.pdf (providing a full list of bilateral treaties in force as of November 1, 2007, organized by subject).

administrative assistance in the prevention of tax avoidance and evasion.[42]

1. Double Taxation Agreements

DTAs form the "backbone" of today's international tax regime, and have become "virtually synonymous with international tax competition."[43] The United States, with few exceptions, taxes its citizens, residents, and domestic corporations on their worldwide incomes, including incomes earned in other countries.[44] US citizens who earn income in another country may also be taxed by the host country, which leads to potential double taxation.[45] To mitigate this possibility, the United States either taxes these earnings and then gives a credit in the amount equal to the foreign tax paid to the source country, or exempts certain types of income from taxation entirely.[46] The United States currently has about sixty income tax DTAs in force.[47]

2. Mutual Legal Assistance Treaties

Mutual Legal Assistance Treaties are negotiated and entered into by the Department of Justice ("DOJ"), and provide

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42. *See* Rev. Proc. 91-23, 1991-11 I.R.B. 1 (describing the various bilateral income taxation treaties and their functions); *see also* JOEL KUNTZ & ROBERT PERONI, U.S. INTERNATIONAL TAXATION ¶ C4.18 (2012 ed. 1991) (pointing to the reduction of double taxation as the "general policy" of income tax treaties).

43. *See* Steven A. Dean, *More Cooperation, Less Uniformity: Tax Harmonization and the Future of the International Tax Regime*, 84 TUL. L. REV. 125, 144 (2009) [hereinafter Dean, *More Cooperation*] (explaining that, over time, these bilateral tax treaties secured a dominant position in international tax regimes); *see also* KUNTZ & PERONI, *supra* note 42, ¶ C4.01 (proposing that income tax treaties help remove tax barriers that would otherwise impede international trade and investment).

44. *See* 26 U.S.C. §§ 901–908, 911 (2012) (listing items excludable from gross income and exempt from taxation); *see also* KUNTZ & PERONI, *supra* note 42, ¶ C4.18 (explaining, generally, income taxation in the United States as it relates to double taxation).

45. *See* 26 U.S.C. §§ 901–908; *see also* Curtin, *supra* note 41, at 35 (describing how the problem of double taxation arises).

46. *See* 26 U.S.C. §§ 901(a), 911 (describing allowance of credit and certain exemptions, respectively); KUNTZ & PERONI, *supra* note 42, ¶ C4.18 (explaining how the US tax credit system works to mitigate double taxation).

47. *See* KUNTZ & PERONI, *supra* note 42, ¶ C4.02 (listing, in table C4-2, all of the Tax Treaties in Force); U.S. INCOME TAXATION TREATIES CURRENTLY IN FORCE, YALE UNIV., http://www.yale.edu/ppdev/Guides/ap/3415GD.03.pdf (last revised Oct. 25, 2012) (enumerating the income tax treaties in force).

cross-jurisdictional assistance in criminal matters.[48] With an MLAT, signatory countries do not have to seek judicial intervention to effect the exchange of evidence across jurisdictions.[49] Rather, each contracting country's designated Central Authority sends requests to the other nation's Central Authority when seeking assistance.[50] The United States entered into its first MLAT with Switzerland in 1973.[51] Throughout the past four decades, the number of MLATs signed or negotiated has steadily grown.[52]

The MLAT between the United States and the Swiss Confederation on Mutual Assistance in Criminal Matters ("Swiss MLAT") played a significant role in the DOJ's efforts to resolve the 2007 UBS banking scandal.[53] With the agreement, the two countries agreed to assist each other in, inter alia, ascertaining the whereabouts of persons, taking testimony, producing judicial and other documents relating to evidence, and serving judicial documents.[54] The Schedule to the treaty lists thirty-five

48. *See* Cynthia R. Shoss, *Mutual Legal Assistance Treaties, in* 2 ASSET PROTECTION: DOMESTIC AND INTERNATIONAL LAW AND TACTICS § 24A:29 (Duncan Osborne & Elizabeth Morgan Schurig eds., 2013) (examining the purposes and identifying features of a standard US Mutual Legal Assistance Treaty ("MLAT")); *see also* L. Song Richardson, *Convicting the Innocent in Transnational Criminal Cases: A Comparative Institutional Analysis Approach to the Problem,* 26 BERKELEY J. INT'L L. 62, 81–82 (2008) (providing a general overview of how MLATs function, their advantages and disadvantages).

49. *See* Schoss, *supra* note 48 (noting that MLATs establish direct channels of communication "Justice-to-Justice" in order to "expedite . . . the provision of all categories of assistance"); *see also* Susan W. Brenner & Lori E. Shaw, *Mutual Legal Assistance Treaties, in* 1 FEDERAL GRAND JURY § 14:4 (2d ed. 2012) (describing the request process).

50. See Brenner & Shaw, *supra* note 49 (noting that the Department of Justice ("DOJ") is designated as the "Central Authority"); *see also* Ian R. Conner, Note, *People's Divided: The Application of United States Constitutional Protections in International Criminal Enforcement,* 11 WM. & MARY BILL RTS. J. 495, 499 (2002) (explaining that the DOJ acts as the Central Authority for the United States).

51. Treaty on Mutual Assistance in Criminal Matters, U.S.-Switz., May 25, 1973, 27 U.S.T. 2019 [hereinafter Swiss MLAT]; *see* Conner, *supra* note 50, at 498 ("The use of the MLAT has expanded since the United States and Switzerland signed the first MLAT in 1973 . . . .").

52. *See* Conner, *supra* note 50, at 498 (noting an expansion to over forty MLATs currently in use since the United States first signed an MLAT with Switzerland); *see also Treaties in Force, supra* note 41 (listing all MLATs currently in force, current through 2012).

53. *See* Swiss MLAT, *supra* note 51; *see also* Conner, *supra* note 50, at 498 nn.14–20 (showing similar features of different MLATs).

54. *See* Swiss MLAT, *supra* note 51, art. 1.

offenses for which compulsory measures are available, such as murder, manslaughter, embezzlement, and forgery.[55] Notably, the treaty does not apply to political offenses, antitrust laws, or with respect to tax law violations.[56]

The United States regards both tax fraud and tax evasion as criminal activity.[57] Contrastingly, while tax fraud is a crime under Swiss law, tax evasion is not.[58] Thus, a treaty request under the Swiss MLAT effectively lifts Swiss bank secrecy laws only in the case of tax fraud, but not simple tax evasion.[59]

3. Tax Information Exchange Agreements

The OECD's first model double taxation treaty, drafted in 1963, reflected negotiating nations' principal concern over double taxation.[60] By 1977, however, the development of complex international business law increased the need to adopt information exchange agreements to enforce domestic tax laws.[61] As such, the OECD recognized the need to revise its

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55. *See id.* sched.

56. *See id.* art. 2.

57. *See* 26 U.S.C. §§ 7201, 7206 (2012).

58. *See* Andand Sithian, Comment, *"But the Americans Made Me Do It!": How* United States v. UBS *Makes the Case for Executive Exhaustion*, 25 EMORY INT'L L. REV. 681, 722 (2011) (explaining that tax fraud is a criminal offense involving the filing of falsified tax documents to mislead tax authorities, whereas tax evasion is a civil misdemeanor for failing to declare income); Lyssandra Sears, *Swiss to Go After Domestic Tax Cheats*, LOCAL (Feb. 24, 2012, 11:30 AM) (quoting Swiss Parliamentarian Jean-Christophe Schwaab), http://www.thelocal.ch/page/view/2674#.URD_VVpFevI ("In Switzerland, a tax offence is considered a trifle while it is a crime in the United States.").

59. *See* Sithian, *supra* note 58, at 714 (explaining that agencies like the IRS were often left without recourse when trying to utilize the Swiss MLAT to pursue tax investigations); Greg Brabec, Note, *The Fight for Transparency: International Pressure to Make Swiss Procedures Less Restrictive*, 21 TEMP. INT'L & COMP. L.J. 231, 253 (2007) (noting that Swiss secrecy laws would only be relaxed for an MLAT request pursuant to tax fraud, but not to tax evasion).

60. *See* JACKSON, *supra* note 9, at 6–7 (stating that double taxation treaties were the OECD's first treaties to tackle the problem of tax havens); *see also* Curtin, *supra* note 41, at 42 ("In 1963 . . . the principal international concern was the elimination of double taxation.").

61. *See* Curtin, *supra* note 41, at 41 (arguing that the expansion of international commerce has been a "catalyst for an ever increasing number of income tax treaties"); *see generally* Steven A. Dean, *The Incomplete Market for Tax Information*, 49 B.C. L. REV. 605 (2008) [hereinafter Dean, *Incomplete Market*] (illustrating the need for standalone administrative assistance agreements in response to the shortcomings of bilateral Double Taxation Agreements ("DTAs")).

model double taxation treaty to provide for exchange of information.[62] Since then, the steady centripetal forces of globalization have made TIEAs a fundamental, and necessary, component of international tax agreements, especially as they relate to tax evasion.[63]

TIEAs are separate from tax treaties, but do not supplant them.[64] Article 26 of the OECD Model Double Taxation Convention on Income and Capital ("OECD Model Tax Convention") generally provides the legal basis for these bilateral information exchange agreements.[65] Their intended purpose is to assist each country in the accurate assessment and collection of taxes, prevent fiscal fraud and evasion, and improve tax information structure through exchanges of information.[66] The United States has signed more than twenty bilateral TIEAs, most of them since 2003, and the majority of which are based on the OECD's 2002 Model TIEA.[67]

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62. *See* CYM H. LOWELL & JACK P. GOVERNALE, U.S. INTERNATIONAL TAXATION: PRACTICE AND PROCEDURE ¶ 9.03:1 (2012 ed. 1998) ("As business expands on a global scale, it becomes increasingly challenging for tax administrators to gather the information necessary to determine the proper tax liability of the entities under its jurisdiction."); *see also* JACKSON, *supra* note 9, at 5–6 (explaining that the OECD updated its 1963 draft to reflect increasingly sophisticated methods of tax evasion, and new and more complex international transactions).

63. *See* Curtin, *supra* note 41, at 43 (stating that the OECD revised its model treaty in part due to the growing widespread concern over fiscal evasion); *see also* Dean, *Incomplete Market*, *supra* note 61, at 650–51 (noting that, while not a "silver bullet" against potential capital flight, TIEAs have had some success).

64. *See* Tax Information Exchange Agreements, I.R.S. Manual Transmittal, IRM 35.4.5.2.4 (Dec. 21, 2010) [hereinafter IRS TIEA] (explaining the principal differences between a TIEA and a tax treaty); *see also* David Spencer, *OECD Model is a Major Advance in Information Exchange (Part 2)*, J. INT'L TAX'N, Nov. 2002, at 10, 12 (2002) [hereinafter Spencer, *Major Advance*] (noting that the OECD's Model TIEA has provisions contrary to most international tax treaties).

65. *See* JACKSON, *supra* note 9, at 8 (arguing that Article 26 of the OECD's Model Tax Convention is "broadly accepted to be the most widely accepted legal basis for bilateral exchanges of information for tax purposes"); *see also* Yates et al., *supra* note 20, at 50 (explaining that more than 3,000 bilateral treaties are based off of Article 26).

66. *See* IRS TIEA, *supra* note 64, para. 1 (describing the usual characteristics of TIEAs); *see also* Curtin, *supra* note 41, at 51 (providing a general overview of exchange of information agreements in the OECD Model Double Taxation Convention on Income and Capital ("OECD Model Tax Convention"), from which standalone TIEAs are derived).

67. *See* ORG. FOR ECON. CO-OPERATION AND DEV., AGREEMENT ON EXCHANGE OF INFORMATION ON TAX MATTERS 4–13 (2002), *available at* http://www.oecd.org/ctp/exchangeofinformation/2082215.pdf (providing an example of the model bilateral TIEA); *see also* Hedda Leikvang, Note, *Piercing the Veil of Secrecy: Securing Effective*

TIEAs can be severely limited in their practical application. [68] The agreements generally do not require requested countries to automatically provide a requesting nation with tax information, nor furnish any information that it otherwise would not collect in the normal administration of their own laws.[69] The effectiveness of a TIEA is predicated upon the assumption that the requesting state knows the identity of the tax evader before making the request, and that the requested state routinely collects the type of information sought.[70] Thus, a "fishing expedition"—using a TIEA to acquire new, unknown information about a taxpayer that could not have been determined but for the expedition—is generally not permissible under US tax treaties.[71] For example, under its TIEA with Switzerland, the United States must first know the full identity of the accountholder before it can send a treaty

Exchange of Information to Remedy the Harmful Effects of Tax Havens, 45 VAND. J. TRANSNAT'L L. 293, 314 (2012) (explaining that most of the TIEAs that the United States has entered into are based on the OECD's model agreement).

68. *See* Susan Morse, *Tax Compliance and Norm Formation Under High-Penalty Regimes,* 44 CONN. L. REV. 675, 707 (2012) (detailing that the UBS case forced Switzerland to renegotiate its TIEA with the United States); *see also* Lee A. Sheppard, *Will U.S. Hypocrisy on Information Sharing Continue?,* 138 TAX NOTES 253, 255 (2013) (arguing that if a TIEA were effective at all, "tax havens wouldn't sign it").

69. *See* Yates et al., *supra* note 20, at 53 (arguing that the lack of automatic exchange of information is one of the TIEA's biggest limitations); *see also* Bruce Zagaris, *The Procedural Aspects of U.S. Tax Policy Towards Developing Countries: Too Many Sticks and No Carrots?,* 35 GEO. WASH. INT'L L. REV. 331, 341 (2003) [hereinafter Zagaris, *Sticks and Carrots*] (explaining that the requested state "need not implement administrative measures at variance with its own laws" or supply information that it could not obtain under its own laws).

70. *See* Morse, *supra* note 68, at 707 (noting that TIEAs only lift the veil of bank secrecy if the requesting country "provides a detailed request naming the taxpayer"); *see also* Zagaris, *Sticks and Carrots, supra* note 69, at 341 (explaining that requested states do not need to furnish information they would not otherwise collect).

71 . *See* JOSÉ LUIS ESCARIO DÍAZ-BERRIO, FUNDACIÓN ALTERNATIVAS [ALTERNATIVES FOUNDATION], THE FIGHT AGAINST TAX HAVENS AND TAX EVASION: PROGRESS SINCE THE LONDON G20 SUMMIT AND THE CHALLENGES AHEAD 38 (2011) (Spain) (articulating that fishing expeditions "prevent countries making imprecise requests aimed at detecting irregularities"); Eric M. Victorson, Note, United States v. UBS AG*: Has the United States Successfully Cracked the Vault into Swiss Banking Secrecy?,* 19 CARDOZO J. INT'L & COMP. L. 815, 821 (2011) (describing Model TIEAs as preventing "fishing expeditions" because the first country must demonstrate that it has exhausted all possible means of acquiring the information sought and that the information is foreseeably relevant).

request.[72] These inherent limitations on the ability to access accountholder information contributed to Congress's decision to enact FATCA, which forces FFIs to automatically report information about its US clients directly to the IRS.[73]

C. *The UBS Scandal*

The UBS scandal thrust the issue of offshore tax evasion into the fore, and helped set the stage for FATCA's enactment.[74] In 2007, former UBS banker Bradley Birkenfeld blew the whistle to the IRS that UBS had been actively helping US clients conceal their offshore accounts.[75] According to Birkenfeld, from at least 2000 to 2007, UBS helped US clients open Swiss accounts with fraudulently listed foreign beneficial owners, and then represented to the IRS that these accounts were non-US-owned, non-US bank accounts outside of the IRS's disclosure requirements.[76] The bank induced American investment by

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72. *See* DÍAZ-BERRIO, *supra* note 71, at 38 (explaining that under the Model TIEA, the request must include "very detailed information about the taxpayer" and that many developing countries may lack the resources necessary to gather the requested evidence); Morse, *supra* note 68, at 707 (noting the requirement to provide a detailed request of the taxpayer in question).

73. *See* Stafford Smiley, *President Obama's Efforts at International Tax Reform*, CORP. TAX'N, Feb. 2011, at 24, 28 (explaining that FATCA puts into a place a new regulatory structure whereby FFIs "police the identities of their accountholders and assure that U.S. taxpayers pay the appropriate U.S. taxes"); *see also* Bruce Zagaris, *U.S. Issues Final FATCA Regs to Jump Start International Tax Enforcement*, 29 INT'L ENFORCEMENT L. REP. 42, 43 (2013) ("As the U.S. and foreign governments continue to break down the barriers between sharing tax information with other law enforcement agencies, FATCA has critical importance.").

74. *See* Laura Szarmach, Note, *Piercing the Veil of Bank Secrecy? Assessing the United States' Settlement in the UBS Case*, 43 CORNELL INT'L L.J. 409, 410 (2010) (describing the scandal as "the most high profile illustration of government action against offshore tax evasion"); Lisa Jucca, *Offshore Private Banking Model is Dead After UBS Probe, Experts Say*, REUTERS (Sept. 1, 2009), http://blogs.reuters.com/financial-regulatory-forum/2009/09/01/offshore-private-banking-model-is-dead-experts-say/ (quoting a wealth manager at Deutsche Bank as saying that the consequences of the UBS scandal were "dramatic").

75. *See* Victorson, *supra* note 71, at 846 (reporting that the whistleblower program was cited by Birkenfeld as a reason why he came forward to the US authorities); *see also* Kevin McCoy, *12 Key Figures Prosecuted in UBS Tax Evasion*, USA TODAY (Oct. 13, 2009, 7:39 PM), http://usatoday30.usatoday.com/money/perfi/taxes/2009-10-13-key-figures-ubs-tax-evasion-case_N.htm (listing Birkenfeld at the top amongst the list of key figures prosecuted by the DOJ with a description of their crimes).

76. *See* STAFF OF PERMANENT SUBCOMM. ON INVESTIGATIONS OF THE S. COMM. ON HOMELAND SEC. AND GOVERNMENTAL AFFAIRS, 110TH CONG., REP. ON TAX HAVEN

assuring its US clients that the IRS would never find out about these accounts because the bank would not be required to disclose them, and further, that the accounts would be shielded by Switzerland's bank secrecy laws.[77] On June 19, 2008, Bradley Birkenfeld pled guilty to conspiring to defraud the IRS by helping US clients hide US$20 billion in assets, avoiding US reporting requirements.[78]

On February 18, 2009, after protracted negotiations that were leveraged by criminal proceedings initiated in the Southern District of Florida, the DOJ secured a Deferred Prosecution Agreement ("DPA") whereby UBS admitted guilt to fraud and conspiracy, and agreed to provide the United States with the identities of, and account information for, certain US customers.[79] The bank further agreed to pay a US$780 million settlement in exchange for the DOJ's discontinuance of its criminal prosecution.[80]

In August 2009, before the federal court made a ruling, the two countries negotiated an agreement (the "2009 Agreement") whereby Switzerland agreed to permit UBS to disclose the names of approximately 4,500 US accountholders in exchange

BANKS AND U.S. TAX COMPLIANCE 11 (Comm. Print 2008) [hereinafter REP. ON TAX HAVEN BANKS] (describing the method by which UBS created allegedly non-disclosable accounts); *see also* Szarmach, *supra* note 74, at 410 (explaining that UBS opened accounts in the name of "sham entities" to act as the foreign beneficial owner).

77. *See* REP. ON TAX HAVEN BANKS, *supra* note 76, at 10 (describing UBS assurances that bank secrecy laws would prevent US authorities from learning the true beneficial owner of the accounts); *see also* Szarmach, *supra* note 74, at 410–14 (outlining how UBS generally induced US clients to evade taxes).

78. *See* REP. ON TAX HAVEN BANKS, *supra* note 76, at 9 (reporting that Birkenfeld was charged with personally hiding US$200 million in assets, and evading US$7.2 million in taxes); *see also* DOJ Press Release No. 08-579 (June 30, 2008), *available at* http://www.justice.gov/opa/pr/2008/June/08-tax-579.html (detailing the circumstances of Birkenfeld's arrest).

79. *See* DOJ Press Release No. 09-136 (Feb. 18, 2009), *available at* http://www.justice.gov/opa/pr/2009/February/09-tax-136.html (reporting the conditions of the Deferred Prosecution Agreement ("DPA")); *see also* Chad Bray, *Swiss Bank Pleads Guilty in Probe*, WALL ST. J. (Jan. 3, 2013, 3:43 PM), http://online.wsj.com/article/SB10001424127887323874204578219572734283146.html (explaining that the UBS scandal "set off tensions" between the United States and Switzerland over Switzerland's bank secrecy laws).

80. *See* DOJ Press Release No. 09-136, *supra* note 79 (detailing the circumstances that led to the DPA); *see also* Deferred Prosecution Agreement para. 3, United States v. UBS AG, No. 09-60033-CR-COHN, 2009 WL 611877 (S.D. Fla. 2009) [hereinafter DPA].

for withdrawal of the criminal proceedings in the district court.[81] Switzerland had previously threatened to seize data from UBS to ensure that that the bank could not comply with the order, and insisted that the United States only obtain the information through a treaty request.[82]

Consistent with this view, the Swiss Federal Administrative Court ruled that the 2009 Agreement did not validly supersede Article 26 of the 1996 Double Taxation Agreement between the United States and the Swiss Confederation ("Swiss DTA").[83] In the ruling, the court explained that the 2009 Agreement provided a "general understanding," but could not be viewed to override the Swiss DTA's standard of "tax fraud and the like" found in Article 26.[84] Thus, despite the 2009 Agreement, domestic banking secrecy laws still prevented the disclosure of some accountholder information.[85] The two houses of Swiss Parliament, however, eventually voted to overrule the January

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81. *See* Agreement on the Request for Information from the Internal Revenue Service of the United States of America Regarding UBS AG, a Corporation Established Under the Laws of the Swiss Confederation, U.S.-Switz., art. 3, Aug. 19, 2009, 2009 WL 2524345 [hereinafter 2009 Agreement] (detailing the terms of the settlement agreement); *see also* Szarmach, *supra* note 74, at 432–33 (outlining the criteria used by Switzerland to identify the 4,500 accountholders ultimately handed over).

82. *See* Helena Bachmann, *U.S. vs. UBS: A Fight Over Secret Swiss Bank Accounts*, TIME (Jul. 15, 2009), http://www.time.com/time/business/article/0,8599,1910389,00.html ("Citing bank-client confidentiality guaranteed in the Swiss constitution, Switzerland's government has forbidden UBS from complying."); David Jolly, *Swiss Vow to Block UBS from Providing Data to U.S.*, N.Y. TIMES (July 8, 2009), http://www.nytimes.com/2009/07/09/business/global/09ubs.html?dbk (reporting that the Swiss Government, "vowing to protect its vaunted bank secrecy laws," would rather seize the data than permit UBS to hand it over).

83. Bundesverwaltungsgericht [BVGE] [Federal Administrative Court] Jan. 21, 2010, Abteilung I, A-7789/2009, *available at* www.bundesverwaltungsgericht.ch (search the court opinions for "A-7789/2009"; find the opinion under Jan. 21, 2010).

84. *See id.*; *see also* John R. Schmertz & Mike Meier, *Swiss Administrative Court Agrees with U.S. Taxpayer that Bank Data Does Not Have to be Provided to IRS Despite Assistance Agreement Between Switzerland and the U.S.*, 16 INT'L L. UPDATE 29, 30 (2009) ("[Under the Swiss-DTA standard,] a fraudulent act must occur which causes the reduction of tax liability. No Swiss court has decided whether 'mere' evasion of large tax amounts is fraudulent behavior within the meaning of the [Swiss-DTA].").

85. *See* Lynnley Browning, *Swiss Back Away from Deal to Give Names of Rich UBS Clients to U.S.*, N.Y. TIMES, Jan. 27, 2010, at B3 (writing that two Swiss courts had ruled that disclosure would violate Switzerland's bank secrecy laws); *see also Swiss Court Halts Release of Some UBS Account Holder Data*, J. ACCT. (Jan. 25, 2010), http://www.journalofaccountancy.com/Web/20102540.htm (reporting that the Swiss court held that UBS did not have to hand over the names of confidential data under the 2009 Agreement).

2010 Federal Administrative Court ruling, and approved the handover of client data.[86]

The scandal eventually lead to an agreement that gave Swiss banks permission to provide US authorities with some accountholder information, which subsequently caused a broader investigation of numerous Swiss banks.[87] Recently, Wegelin & Co., Switzerland's oldest bank, shut its doors permanently after it pled guilty to criminal conspiracy charges that it hid more than US$1 billion in assets from the IRS, even servicing clients lost by UBS after the bank signed the DPA.[88] Several other banks, including Credit Suisse, Julius Baer, and Züricher Kantonal Bank are the subjects of DOJ investigations, which Swiss Parliamentarian Christian Levrat has called a

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86. *See U.S.-Switzerland Protocol Will Allow Handover of UBS Account Holder Information*, J. ACCT. (Mar. 31, 2010), http://www.journalofaccountancy.com/Web/20102754.htm (explaining that the new protocol would provide a legal basis for complying with the 2009 Agreement); *see also Parliament Approves UBS Agreement*, FED. AUTHORITIES SWISS CONFEDERATION (June 17, 2010), http://www.news.admin.ch/message/index.html?lang=en&msg-id=33742 (reporting that the Swiss Parliament approved the agreement by thirty-one votes to nine).

87. *See* Giles Broom, *HSBC, Credit Suisse Sacrifice Employees to U.S., Lawyers Say*, BLOOMBERG (Aug. 16, 2012, 3:23 AM), http://www.bloomberg.com/news/2012-08-15/hsbc-credit-suisse-sacrifice-staff-to-placate-u-s-lawyers-say.html (noting that while Swiss companies are usually prohibited from sending evidence to assist non-Swiss legal proceedings, the Federal Council granted an exemption in April 2012); *see also* Sean O'Hare, *Switzerland's Oldest Bank Closes After Admitting it Helped 100 Americans Avoid Paying $1.2billion in Tax*, DAILY MAIL (Jan. 4, 2013, 8:02 AM), http://www.dailymail.co.uk/news/article-2257119/Wegelin–Co-closes-admitting-helped-100-Americans-avoid-paying-1-2bn-tax.html (describing that the crackdown on Swiss banking started with the 2007 investigation of UBS).

88. *See* Nate Raymond & Lynley Browning, *Swiss Bank Wegelin to Close After Guilty Plea*, REUTERS (Jan. 4, 2013, 8:27 AM), http:// www.reuters.com/article/2013/01/04/us-swissbank-wegelin-idUSBRE9020O020130104 (detailing Wegelin's agreement to pay US$20 million in restitution to the IRS, a civil forfeiture of US$15.8 million, and a US$22.05 million fine, and would cease to operate as a bank); Marlene Y. Satter, *Swiss Banks Giving Up Employees to IRS, DOJ*, THINKADVISOR (Aug. 16, 2012), http://www.thinkadvisor.com/2012/08/16/swiss-banks-giving-up-employees-to-irs-doj (reporting that Wegelin had taken over US clients from UBS and continued to facilitate those clients' evasion of US tax laws after the UBS scandal); DOJ S.D.N.Y. Press Release No. 13-068 (Mar. 4, 2013) [hereinafter 2013 Press Release], *available at* http://www.justice.gov/usao/nys/pressreleases/March13/WegelinSentencingPR.php (reporting that, on March 4, 2013, Wegelin was formally sentenced in the Southern District of New York and ordered to pay approximately US$58 million in fines, restitution, and forfeitures in the first-ever sentence of a non-US bank indicted for facilitating tax evasion).

"catastrophe" for the banking industry.[89] Demonstrating the extent to which these DOJ investigations are influencing Swiss bank behavior, two other Swiss banks, Pictet & Cie and Lombard Odier, recently changed their centuries-old structures from unlimited partnerships in favor of corporate partnerships, which largely shield individuals from personal liability for most organizational misconduct.[90]

II. *US EFFORTS TO PREVENT TAX ARBITRAGE*

Part II analyzes the causes and effects of international tax arbitrage, and the different ways in which the United States as sought to prevent this arbitrage to help reduce the federal tax gap. Part II.A begins by examining the Qualified Intermediary ("QI") program, one of the methods employed by the United States to reduce tax arbitrages, and how UBS was able to exploit several of the program's weaknesses. Part II.B.1 describes recent responses by the US Congress and the US Departments of Treasury and Justice to combat tax evasion through voluntary

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89. *See* James Schotter, *Swiss Banking Reels From Latest Aftershock*, FIN. TIMES (Feb, 5, 2013, 10:14 PM), http://www.ft.com/intl/cms/s/0/96d4a10e-6fa5-11e2-b906-00144feab49a.html#axzz2LM2XHo5s (describing the allegations by US authorities that Wegelin's behavior was common in the Swiss banking industry as "alarming" for the Swiss banks currently under investigation); *see also* Editorial, *The Fight Against Tax Evasion*, N.Y. TIMES, Feb. 9, 2012, at A26 (noting the possibility of more indictments to come after the Wegelin indictment and the DOJ's investigation of multiple Swiss banks).

90. *See* Giles Broom, *Pictet, Lombard Odier to Drop Centuries-Old Bank Structure*, BLOOMBERG (Feb. 6, 2013, 11:10 AM), http://www.bloomberg.com/news/2013-02-05/pictet-lombard-odier-to-disclose-results-under-new-legal-status.html (noting that the move might signal an end to Swiss bankers assuming unlimited personal liability); *see also* Schotter, *supra* note 89 (reporting a break from a "banking model that has survived for more than two centuries, and whose strength and durability lay in reassuring clients that their interests and those of the partners managing their money were nicely aligned"). Immediately preceding the publication of this Comment, the United States and Switzerland signed an agreement that includes fines for banks found to have facilitated tax evasion in exchange for non-prosecution agreements. The settlement divides banks into four categories: (1) banks already under criminal investigation by the DOJ who will accept fines in exchange for non-prosecution; (2) banks that believe they may have violated US tax law who will accept smaller fines in exchange for information on their cross-border business; (3) banks that believe that they have not violated US tax law; and (4) banks whose business is local. It is expected that the deal could produce more than US$1 billion in penalties, and produce more accountholder information. *See* Neil Maclucas, *US, Switzerland Sign Agreement to Settle Tax Dispute*, WALL ST. J. (Sept. 3, 2013, 3:36 PM), http://online.wsj.com/article/BT-CO-20130830-702365.html.

disclosures, while Part II.B.2 discuss the enactment and provisions of FATCA. Part II.C continues by exploring the global market for tax information as it relates to FATCA-like bilateral agreements. Specifically, Part II.C.1 examines holdout incentives in the theoretical game for this tax information, and Part II.C.2 describes tax flight treaties, a proposed solution to this holdout problem. Finally, Part II.D concludes by assessing the impact that FATCA has currently had on the global fight against tax evasion, and discusses the potential costs that FATCA compliance might require.

A. *"Unqualified" Intermediaries: "The Way to Make People Trustworthy is to Trust Them"*[91]

The IRS established the QI Program in 2001.[92] The UBS scandal helped expose significant weaknesses in the program, to which the US Congress subsequently responded through the implementation of FATCA.[93] It was designed to provide FFIs the option of more simplified withholding and reporting obligations if they agreed to become withholding agents for the IRS and comply with US tax laws.[94] Under the terms of these agreements, a compliant QI would obtain required tax forms, W-9 or W-8BEN, from all of its clients, identifying the client as either a US

91. Letter from Ernest Hemingway to Dorothy Connable (Feb. 17, 1953), *in* ERNEST HEMINGWAY SELECTED LETTERS 1917–1961, at 805 (Carlos Baker ed., 2003). Coincidentally, in the latter years of Ernest Hemingway's life, the author developed an irrational fear that the US government was after him for, amongst other things, tax evasion. *See* Roger Jaynes, *The Legend, the Man*, MILWAUKEE J., Aug. 4, 1980, at 8 ("Mentally he was ruled by two obsessions—that someone was trying to kill him, and that the federal government was after him for tax evasion.").

92. *See* Rev. Proc. 2000-12, 2000-1 C.B. 387 (providing the final Qualified Intermediaries ("QI") Agreement and relevant implementation procedures); *see also* *IRS Signs Qualified Intermediary Agreements*, UNCLE FED'S TAX BOARD (Oct. 26, 2000), http://www.unclefed.com/Tax-News/2000/nr00-74.html (outlining some of the benefits that QIs received over non-QIs).

93. *See* Morse, *supra* note 68, at 723–24 (noting that FATCA builds on the development of the QI program); *see also* Yates et al., *supra* note 20, at 56 (comparing the provisions of FATCA as being similar to the QI rules).

94. *See* REP. ON TAX HAVEN BANKS, *supra* note 76, at 22; *see also* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-099, QUALIFIED INTERMEDIARY PROGRAM PROVIDES SOME ASSURANCE THAT TAXES ON FOREIGN INVESTORS ARE WITHHELD AND REPORTED, BUT CAN BE IMPROVED 3 (2007) ("The QI program contains features that give the IRS some assurance that QIs are more likely to properly withhold and report tax on U.S. source income sent offshore than other withholding agents.").

or non-US resident, and report to the IRS information about taxpayers who self-identified as US citizens.[95]

As a QI, UBS was able to conceal account identity information from the IRS by directing its US clients to refrain from filling out W-9s.[96] Because the clients did not file W-9 forms with UBS, the bank did not file an informational return, Form-1099, with the IRS to report taxable income.[97] Under the terms of these QI agreements, the IRS would not audit a QI if an approved external auditor conducted an audit on the IRS's behalf.[98] In a report subsequent to the scandal, the US Government Accounting Office found that a significant flaw in the QI agreements was that the agreements were silent as to whether external auditors were required to follow-up on indications of fraud or illegal acts by the QI.[99]

UBS's decade-long practice of fraud and deceit highlighted many of the problems the United States has faced in employing a system of worldwide taxation coupled with compliance, the enforcement of which is largely dependent upon tax treaties between two nations with disparate tax laws.[100] Switzerland's initial refusal to permit UBS to release client information

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95. *See* REP. ON TAX HAVEN BANKS, *supra* note 76, at 23 (explaining the QI program process to certify US account holders); *see also* Treas. Reg. § 1.1441-1(e)(5) (providing client identification requirements).

96. *See* REP. ON TAX HAVEN BANKS, *supra* note 76, at 16 (describing the methods used by UBS to facilitate tax evasion on behalf of their US clients); *see* Morse, *supra* note 68, at 712 (detailing how UBS "deliberately designed workarounds" to avoid its responsibilities as a QI).

97. *See* REP. ON TAX HAVEN BANKS, *supra* note 76, at 9 (reporting that UBS never filed the appropriate 1099 Forms with the IRS); *see also* STAFF OF JOINT COMM. ON TAX., 111TH CONG., TAX COMPLIANCE AND ENFORCEMENT ISSUES WITH RESPECT TO OFFSHORE ACCOUNTS AND ENTITIES 34 (Joint Comm. Print 2009) [hereinafter JCX QI] (noting that QIs were entitled to rely on the certification of non-US status on a Form W-8BEN).

98. *See* JCX QI, *supra* note 97, at 22 (describing the audit provisions of the QI Agreement); *see also* REP. ON TAX HAVEN BANKS, *supra* note 76, at 24 (reporting that QIs submit to external auditors of their choosing).

99. *See* REP. ON TAX HAVEN BANKS, *supra* note 76, at 24 (finding a significant flaw in the QI agreements whereby the IRS was generally incapable of reviewing the raw information reviewed by the external auditor); *see also* JCX QI, *supra* note 97, at 26 (recommending that the IRS broaden the QI program to require external auditors to report evidence of fraud or illegal activity).

100. *See* REP. ON TAX HAVEN BANKS, *supra* note 76, at 15–17 (finding a number of flaws in the current system of tax enforcement and basing recommendations on the lessons learned from the UBS scandal); *see also* Szarmach, *supra* note 78, at 422–34 (noting that the UBS case demonstrated that the QI program was practically difficult to enforce and functionally weak).

illustrated how limited tax treaties can be in their practical application.[101] While Birkenfeld tipped off the United States to the existence of nearly 50,000 US accounts, the Swiss handed over just 4,500 after a heated legal battle.[102] Some commentators doubt that the United States could have received even those 4,500 names had the Swiss Parliament not overruled the decisions of its Federal Administrative Court.[103]

B. *The ~~Empire~~ Nation Strikes Back*

The UBS incident demonstrated to the United States government that it could no longer rely on QIs to accurately report account information to the IRS.[104] As the DOJ continues to investigate Swiss banks, perhaps the most noticeable development has been what it describes as "dramatic behavior changes," largely due to the perception that the Unite States will ultimately be successful in its probes.[105] The DOJ reported an

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101. *See* Bachmann, *supra* note 82 (detailing how Switzerland viewed its blocking order as "reasonable" given its view that the United States had broken the terms of their treaty that permits the exchange of tax information only in individual cases where a "specific and justified request is made"); *see also* Browning, *supra* note 85, at B3 (describing how an exchange of information pursuant to a treaty request was only permissible for 250 US taxpayers).

102. *See* Peter J. Henning, *What's Next for Swiss Bank Secrecy*, N.Y. TIMES DEALBOOK (Feb. 3, 2010, 1:27 PM), http://dealbook.nytimes. com/2010/02/03/whats-next-for-swiss-bank-secrecy/ (reporting that the deal to hand over 4,500 names to the IRS "ended the quest to compel the bank to disclose records on more than 50,000 accounts"); *see also* Morse, *supra* note 68, at 701 (detailing how the IRS targeted 50,000 UBS accounts during the investigation).

103. *See* David Kocieniewski, *Get Out of Jail Free? No, It's Better*, N.Y. TIMES, Sept. 12, 2012, at A1 (pointing out that the information that Birkenfeld provided was "so helpful" that he would receive the largest ever whistleblower prize in US history); *see also* Laura Saunders & Robin Sidel, *Whistleblower Gets $104 Million*, WALL ST. J. (Sept. 11, 2012, 7:24 PM), http://online.wsj.com/article/SB10000872396390444017504577 645412614237708.html (noting that Birkenfeld's detailed descriptions in the case against UBS lifted the veil of Swiss bank secrecy).

104. *See* Susan C. Morse, *An Analysis of the FBAR High Penalty Regime*, *in* IRS RESEARCH BULLETIN: PROCEEDINGS OF THE 2010 IRS RESEARCH CONFERENCE 49, 57 (Martha Eller Gangi & Allan Plumley eds., 2011) (articulating that the QI Agreement contained a "less-than-airtight" provision that UBS exploited); *see also* Szarmach, *supra* note 82, at 422–23 (explaining that UBS was able to take advantage of a loophole that did not explicitly obligate a QI to disclose the identity of US beneficial owners of non-US-named accounts).

105. *See* I.R.S. Commissioner Doug Shulman, Statement on UBS/Voluntary Disclosure Program (Nov. 16, 2010) [hereinafter I.R.S. Commissioner Statement], *available at* http://www.irs.gov/uac/IRS-Commissioner-Doug-Shulman's-Statement-on-

unprecedented number of US citizens voluntarily coming clean to the IRS for fear that their assets would be discovered eventually.[106] Furthermore, the DOJ has been able to obtain a number of convictions and plea agreements with US citizens who hid money in UBS accounts.[107]

1.Voluntary Disclosure: Oh Come, All Ye Faithful

Citing a favorable atmosphere in the light of the continued prosecutions of tax evaders and facilitators, on March 26, 2009, two years after the DPA with UBS, the IRS announced its 2009 Offshore Voluntary Disclosure Initiative ("2009 OVDI").[108] The 2009 OVDI was designed to encourage taxpayers with hidden offshore assets and income to "come back into the tax system."[109] Those who came forward would avoid the risk of

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UBS–Voluntary-Disclosure-Program ("[T]hose who try to skirt U.S. tax laws by hiding assets and income offshore, and the banks and advisors who help them do it, will find themselves increasingly at risk due to our efforts in this area."); *see also Offshore Compliance Initiative*, U.S. DEP'T JUST., http://www.justice.gov/tax/offshore_compliance_intiative.htm (noting that the DPA with UBS has produced a dramatic change in individual taxpayer compliance).

106. *See* Tax Division, U.S. Dep't of Justice, FY 2013 Congressional Budget 10, *available at* http://webcache.googleusercontent.com/search?q=cache:ld0N-p7ERMcJ:www.justice.gov/jmd/2013justification/office/fy13-tax-justification.docx+&cd=4&hl=en&ct=clnk&gl=us ("Put simply, the word is out that placing assets in foreign accounts no longer provides the protection from disclosure it once did."); *see also* 2013 Press Release, *supra* note 88 (quoting Assistant Attorney General Kathryn Keneally that "time is rapidly running out for taxpayers who think they can still hide").

107. *See* U.S. DEP'T OF JUSTICE, FY 2011 PERFORMANCE AND ACCOUNTABILITY REPORT § II-20 (2011) (describing the various prosecution results of each of the investigations so far, including thirty-one guilty pleas and two ten-year prison sentences for US taxpayers); *see also Offshore Compliance Initiative*, *supra* note 105 (providing links and case descriptions of a number of successful voluntary disclosure program participants).

108. *See* I.R.S. News Release, IR-2009-84 (Sept. 21, 2009) ("Those taxpayers who do not voluntarily disclose their hidden accounts by the new deadline face much harsher civil penalties, where applicable, and possible criminal prosecution."); *see also* TREASURY INSPECTOR GEN. FOR TAX ADMIN., THE 2009 OFFSHORE VOLUNTARY DISCLOSURE INITIATIVE INCREASED TAXPAYER COMPLIANCE, BUT SOME IMPROVEMENTS ARE NEEDED 1 (2011) [hereinafter TIGTA REPORT] (giving an overview of the 2009 OVDI).

109. *See* TIGTA Report, *supra* note 108, at 1 (noting the purpose of the 2009 OVDI); *see also Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers*, INTERNAL REVENUE SERV. (June 26, 2012), http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers (outlining the incentive structure of the 2009 OVDI).

substantial penalties and increased risk of criminal prosecution if later caught by the IRS.[110]

The results of the initiative greatly exceeded expectations. While originally planning on receiving approximately 1,000 disclosures, the 2009 OVDI produced in excess of 14,700 disclosures.[111] As Robert McKenzie, a tax attorney who has handled a number of high-net-worth OVDI clients, has speculated, the IRS has initiated these OVDIs in order to "scare people out of the woodwork."[112] All motives aside, the programs have been undoubtedly successful, as IRS Commissioner Doug Shulman reported that closed cases had averaged more than US$200,000 in tax collections per case.[113]

2. Fool Me Once, Shame on You; Fool Me Twice, Enjoy an Automatic Information Reporting Scheme

Given the success of the OVDIs, it was clear to US authorities that there were many more taxpayers who could, and should, be brought back into the tax system.[114] And, as the UBS incident revealed, the IRS is at a significant disadvantage in its pursuit of tax evaders whose assets were held in countries with strict bank secrecy laws such as Switzerland.[115] As a result, the US

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110. *See* I.R.S., *Voluntary Disclosure Practice*, IRM 9.5.11.9 (Dec. 2, 2009) (providing an overview of the program); *see also* TIGTA REPORT, *supra* note 108, at 1–2 (explaining the incentive structure to induce compliance earlier rather than later).

111. *See* I.R.S. Commissioner Statement, *supra* note 105 (reporting that over 18,000 individuals over the length of the program's history have brought themselves back into the US tax system); *see also* TIGTA REPORT, *supra* note 108, at 4 (citing the disclosure figures).

112. Javet Novack, *UBS Cheats Can Still Come Clean*, FORBES (Sept. 07, 2008, 6:00 AM), http://www.forbes.com/2008/07/08/irs-ubs-taxes-biz-beltway-cz_jn_0709beltway.html (quoting Robert McKenzie on the IRS's use of John Doe summons and OVDI).

113. I.R.S. Commissioner Statement, *supra* note 105.

114. *See* Edward Tanenbaum, *FATCA Brings More Voluntary Disclosures*, 41 TAX MGM'T INT'L J. 517, 517 (2012) ("With the looming FATCA disclosures, taxpayers are beginning to see an end to historical bank secrecy as we know it."); *see also* Eric van Aalst, *FATCA Reporting for Non-Financial Foreign Entities*, WEALTHMANAGEMENT.COM (July 5, 2012), http://wealthmanagement.com/taxes/fatca-reporting-non-financial-foreign-entities (arguing that the US Congress drafted FATCA as a reaction to both the UBS DPA and the self-disclosure of US taxpayers).

115. *See* Peter Lattman, *Swiss Bank Pleads Guilty to Helping American Tax Dodgers*, N.Y. TIMES, Jan. 4, 2013, at B5 (reporting that, even in the wake of the UBS prosecution, Wegelin managed to lure former UBS clients to Wegelin); *see also* Sanat Vallikappen, *U.S. Millionaires Told Go Away as Tax Evasion Rule Looms*, BLOOMBERG (May 8, 2012, 11:46 PM), http://www.bloomberg.com/news/2012-05-08/u-s-millionaires-

Congress enacted Title V of the HIRE Act, FATCA, with the purpose of "clamping down on offshore tax evasion," and giving the United States new tools to "detect, deter and discourage offshore tax abuses."[116]

Under the new FATCA regime, all FFIs are subject to thirty percent withholding on all payments from US-sourced income.[117] Withholding, the process by which the United States generally ensures that it can tax income against non-US persons or business entities that might not have a substantial presence in the United States but still derive income from US-sources, functions by requiring withholding agents to withhold thirty percent of the amount paid from the US-source by the agent that may not be effectively connected with the conduct of the non-US person or entity.[118] Any, and presumably every, FFI that wishes to avoid this tax must enter into an agreement with the IRS to identify US accounts and report: (1) the name, address, and Tax Identification Number ("TIN") of each US accountholder; (2) the account number; (3) the account balance or value; and (4) the gross receipts and gross withdrawals or payments from the accounts.[119] An FFI is further obligated to report annually to the IRS on its financial accounts held by US taxpayers, or by entities in which US taxpayers hold a

told-go-away-as-tax-evasion-rule-looms.html (explaining that FATCA was introduced "after Zurich-based UBS AG said in 2009 that it aided tax evasion by Americans").

116. *See* Press Release, Representative Sander Levin (D-MI), Levin Calls for End to Offshore Tax Abuse (Oct. 27, 2009), *available at* http://levin.house.gov/press-release/levin-calls-end-offshore-tax-abuse (describing the purpose of FATCA, from one of the Act's co-sponsors); *see also* Press Release, U.S. Dep't of Treasury, Treasury and IRS Issue Final Regulations to Combat Offshore Tax Evasion (Jan. 17, 2013), *available at* http://www.treasury.gov/press-center/press-releases/Pages/tg1825.aspx [hereinafter Jan. 17 Press Release] (declaring that Congress enacted FATCA to target non-compliance by US taxpayers).

117. *See* 26 U.S.C. § 1471 (2012) (pertaining to withholdable payments to FFIs under FATCA).

118. *See* I.R.C. § 871(a)(1); § 881 (pertaining to withholdable payments generally); *see also* § 1441; § 1442 (applying this concept of withholding tax to FATCA to incentivize compliance).

119. I.R.C. § 1471; *see also* STAFF OF JOINT COMM. ON TAX., 111TH CONG., TECHNICAL EXPLANATION OF THE "FOREIGN ACCOUNT TAX COMPLIANCE ACT OF 2009" 18 (Joint Comm. Print 2009) [hereinafter JCX FATCA]; *see generally* DLA Piper, The Foreign Account Tax Compliance Act (FATCA), http://www.dlapiper.com/files/Uploads/Documents/FATCA-Alert.pdf (last visited Aug. 22, 2013) [hereinafter DLA Piper FATCA] (providing a succinct overview of the provisions).

substantial ownership interest.[120] Further, a compliant FFI must withhold and pay to the IRS any payments of US-source income, and withhold upon, or close, the accounts of individual accountholders who fail to provide sufficient information to determine their citizenship or any entity accountholders who fail to provide sufficient information to determine whether it is substantially US-owned (collectively, "Recalcitrant Accounts").[121] This provision closes the loophole that allowed UBS to simply ignore Recalcitrant Accounts in the past.[122]

For the purposes of FATCA, a withholdable payment includes: (1) any payment of interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other FDAP gains, profits, and US-source income; and (2) any gross proceeds from the sale or disposition of any property of a type which can produce interest or dividends from sources within the United States.[123] Furthermore, FFIs must attempt to obtain a waiver of any non-US law that would prevent reporting the required information or close the account.[124]

C. *Assessing FATCA's Value in the Market for Information*

As Professor Steven A. Dean opines, there is a market for tax account information.[125] Congress enacted FATCA based on the demonstrated need to acquire account information from

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120. § 1471(b)(1)(C).

121. § 1471 (defining, generally, a "substantial United States owner," as a US citizen who owns a ten percent stake in a corporation, partnership, or trust); *see* DLA Piper FATCA, *supra* note 119, § I.F (explaining that FFIs are required to shut a recalcitrant account down if it does not impose the required withholding tax on the account).

122. *See supra* notes 92–99 and accompanying text (detailing how UBS intentionally created a situation in which they "wouldn't know" the national origin of some of their accountholders).

123. § 1473(1).

124. *See* § 1471(b)(1)(F); *see also* I.R.S. Notice 2010-60, IRB 2010-37 (original notice and request for comments in implementing FATCA).

125. *See* Dean, *Incomplete Market*, *supra* note 61, at 606 (arguing that the participants in this market are typically individuals and businesses, and that while governments "rely heavily on information, usually they do not pay for that information"); *see also* Alex Rashkolnikov, *Crime and Punishment in Taxation: Deceit, Deterrence, and the Self-Adjusting Penalty*, 106 COLUM. L. REV. 569, 642 (2006) (explaining that millions of taxpayers earn income "not subject to any monitoring regime," and are thus incentivized to shift billions in assets towards tax havens).

citizens who hold assets in overseas institutions.[126] The failure of the QI program, as exemplified by the UBS scandal and subsequent actions by Switzerland, brought to light many limitations inherent in these agreements that the United States had been signing with tax haven countries.[127] The largest hindrance to enforcing tax laws, and the greatest hurdle to FATCA's success, is extraterritorial information asymmetry.[128] This asymmetry exists because the taxpayer theoretically knows which transactions should be reported to the IRS, but the IRS lacks the same knowledge unless the taxpayer voluntarily discloses it or it is obtained from a third party.[129] While then Treasury Secretary Paul O'Neill denounced OECD's 1998 Report for dictating what a country's tax rates should be, he did, however, explicitly acknowledge that the United States needs information from offshore countries to prosecute tax evaders.[130] Tax havens can prove particularly obstructionist to other,

126. *See* Jan. 17 Press Release, *supra* note 116 (announcing that FATCA requires FFIs to report to the IRS information about financial accounts held by US taxpayers); *see also Scratched by the FATCA*, ECONOMIST, Nov. 26, 2011, at 86, 86–87 (noting that in fund managers' attempts to report information about their client to the IRS, there might be "several layers of intermediation between the fund" and the client that the manager would have "to look through all these layers").

127. *See* JCX QI, *supra* note 97, at 9 (outlining some of the weaknesses of the QI agreement with UBS); *see also supra* notes 57–59 and accompanying text (demonstrating how the Swiss MLAT proved largely ineffectual).

128. *See* Dean, *Incomplete Market*, *supra* note 61, at 630 ("The heart of the problem lies in the vast gulf between the information to which tax authorities have access domestically and the information they are able to collect abroad."); *see also* Leandra Lederman, *Reducing Information Gaps to Reduce the Tax Gap: When is Information Reporting Warranted?*, 78 FORDHAM L. REV. 1733, 1734–36 (2010) [hereinafter Lederman, *Reducing Information Gaps*] (explaining that information reporting is largely used to address this deficiency).

129. *See* Lederman, *Reducing Information Gaps*, *supra* note 128, at 1733 (explaining that the government is "forced to play catch-up," and must rely solely on the taxpayer's honesty or third-party reporting); *see also* Rashkolnikov, *supra* note 125, at 611 (explaining that evasion on income not subject to information reporting is "simple . . . one simply falsifies the income on the return").

130. *See* Press Release, Paul O'Neill, Sec'y, U.S. Dep't of Treasury (May 10, 2001), *available at* http:// www.treasury.gov/press-center/press-releases/Pages/po366.aspx [hereinafter O'Neill Press Release] (reporting that the United States could never have obtained convictions of tax evaders that were using the Cayman Islands without a TIEA with the Cayman Islands).

higher-tax-liability nations by withholding or failing to collect this critical information.[131]

1. Bilateral Holdout and Flight Incentive

FATCA attempts to solve extraterritorial tax information asymmetry by enlisting FFIs to pull US taxpayers back into the IRS's information scheme.[132] FFIs must now directly provide the account information that the IRS had been unable to access under the previous QI program, or be deemed "noncompliant."[133] FATCA will attempt to force compliance with increased penalties and a hefty thirty percent withholding tax on noncompliant FFIs.[134]

Consequently, FATCA's bilateral nature may potentially be subject to the problem that Professors Dean and Rosenzweig argue are inherent in bilateral treaties with tax havens: the holdout incentive created by tax arbitrage.[135] Tax havens provide the structure and incentive for US taxpayers to engage in tax arbitrage, whereby assets are shifted into offshore accounts in lower-tax jurisdictions to avoid higher domestic taxes.[136] In

131. *See, e.g., supra* notes 68–73 and accompanying text (highlighting some of the practical limitations of TIEAs).

132. *See* 26 U.S.C. § 1471(c)(1) (2012) (requiring that compliant FFIs report directly to the IRS on an annual basis the name, address, TIN, account number, account balance, and gross receipts and withdrawals of all US clients); *see also* Remy Farag, *Shulman Discusses Joint Audits and FATCA Developments*, J. INT'L TAX'N, Sept. 2010, at 5, 5 (quoting IRS Commissioner Douglas Shulman as saying that FATCA is "the most important international information reporting legislation enacted in a generation").

133. *See* § 1471(c)(1) (describing the agreement that FFIs must enter into with the IRS); *see also* JCX QI, *supra* note 97, at 8–10 (using the case of UBS to exemplify the weaknesses of the previous QI program).

134. *See* § 1471(a) (mandating a thirty percent tax deduction for all FFIs that do not meet the reporting and due diligence requirements); *see also* Farag, *supra* note 132, at 6 (asserting that FATCA increases information reporting through the "imposition of stiff penalties for failure to comply" by US citizens and increased withholding taxes on FFIs).

135. *See* Dean, *Incomplete Market, supra* note 61, at 628–30 ("[T]he existence of offshore tax havens provides a form of 'virtual' expatriation: tax flight."); *see also* Rosenzweig, *International Arbitrage*, supra note 23, at 584–86 (arguing that while multilateral cooperation might overcome this problem, international tax arbitrage suffers from this holdout problem).

136. *See* Dean, *More Cooperation, supra* note 43, at 147 (explaining that tax flight occurs when taxpayers "camouflage" their assets offshore); *see also* Adam H. Rosenzweig, *Why Are There Tax Havens?*, 52 WM & MARY L. REV. 923, 940 (2010) [hereinafter Rosenzweig, *Tax Havens*] (providing one view that tax havens distort economic decision making).

theory, this shifting of assets occurs only because of the favorable tax implications.[137]

For example, if two countries, Country A and Country B, share a Double Taxation Agreement for a single item of income, Item X, there would be no advantage to shifting Item X between Country A or B.[138] The ultimate tax liability would be effectively identical either through harmonization or a tax credit.[139] A tax haven, Country C, however, distorts this equilibrium of tax liabilities by introducing a tax advantage that potentially diverts the tax revenue on Item X away from either Country A or Country B, and towards Country C.[140]

Although FATCA's automatic reporting requirements address previous shortcomings in the fight over global information asymmetry, the onerous withholding penalties do not fully disincentive tax arbitrage.[141] Thus, there will always be

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137. *See* Steven A. Dean, *Philosopher Kings and International Tax: A New Approach to Tax Havens, Tax Flight, and International Tax Cooperation*, 58 HASTINGS L.J. 911, 928–29 (2007) [hereinafter Dean, *Philosopher Kings*] (defining tax flight); *see also* Rosenzweig, *Tax Havens*, *supra* note 136, at 930 (2010) (describing the relationship between tax havens and tax competition).

138. *See* Rosenzweig, *Tax Havens*, *supra* note 136, at 951 ("[If Country A and Country C had Double Taxation Agreements], there would be no amount of tax competition Country C could engage in to attract the capital. Even if Country C offered a zero tax rate, the capital would have no incentive to leave Country A since it would pay the full Country A tax regardless of where it was located. The only thing that makes tax competition a useful instrument for Country C is the ability to exploit the anti-double-taxation regimes of Country A."); Dean, *Philosopher Kings*, *supra* note 137, at 943 (noting that the "extraordinary success of bilateral double tax treaties" is usually attributed to their impact on taxpayer decision making).

139. *See* Julie Roin, *Competition and Evasion: Another Perspective on International Tax Competition*, 89 GEO. L.J. 543, 554 (2001) ("One of the tenets of the tax harmonization argument [with, for example, DTAs] is that competition will force all jurisdictions to lower their tax rates to the same low (or zero) levels, such that no country will offer investors a 'better' tax deal relative to other countries."); *see also* Rosenzweig, *Tax Havens*, *supra* note 137, at 936–39 (providing an example of how a DTA might affect the business decisions of a multinational corporation).

140. *See* Dean, *More Cooperation*, *supra* note 43, at 128–29 (explaining how tax havens provide the option of virtual expatriation); *see also* Adam Rosenzweig, *Thinking Outside the (Tax) Treaty*, 2012 WIS. L. REV. 717, 720 (2012) [hereinafter Rosenzweig, *Tax Treaty*] (describing an issue that "plagues" modern international tax regimes as that of "double non-taxation, or escaping tax altogether").

141. *See supra* notes 117–21 and accompanying text (describing the FATCA reporting requirements); *see also* Rosenzweig, *Tax Havens*, *supra* note 136, at 940 (providing that tax arbitrage exists to minimize tax liability).

an incentive to holdout from entering into an agreement.[142] According to Professor Susan C. Morse's analysis of high-penalty regimes, the success of FATCA depends on: (1) penalty credibility; (2) detection and information strategies; and (3) the lack of close substitutes.[143] The automatic reporting requirements and withholding tax may effectively mitigate concerns with respect to (1) and (2), but the existence of tax havens provide "close substitutes" for penalized behavior and may undermine FATCA's effectiveness.[144] As Professor Morse argues, "[t]he success of a high penalty for a particular infraction requires the absence of sufficiently close substitutes for the penalized action. The penalty will be less effective if the taxpayer can make choices that achieve the goal of tax evasion without incurring a penalty."[145] Thus, FATCA would be unsuccessful as a high-penalty regime if FFIs and US taxpayers view a noncompliant FFI or country as a close substitute of a compliant FFI or country.[146]

Although FATCA fails to address this phenomenon, the tax treaties and agreements discussed in Part I.B attempt to minimize the incentive to engage in tax arbitrage through tax

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142. *See* J. Richard Harvey, Jr., *Offshore Accounts: Insider's Summary of FATCA and its Potential Future*, 57 VILL. L. REV. 471, 480 (2012) (noting that the new QI system "needed to have a penalty" that came in the form of the imposition of a withholding tax on noncompliant FFIs); *see also* Morse, *supra* note 68, at 724–25 ("[A]t first glance . . . FATCA's withholding penalty is so onerous that it must be avoided at all costs.").

143. *See* Morse, *supra* note 68, at 688–93 (arguing that all three components are required for effective high-penalty reporting regimes); *see also* Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 OHIO ST. L.J. 1453, 1508 (2003) (arguing that it may be possible to increase tax compliance "by reducing the opportunity for noncompliance, such as through increased enforcement of the tax laws").

144. *See* Morse, *supra* note 68, at 691–92 (explaining that the absence of close substitutes is the "key to success" to a strategy that imposes high penalties); *see also* Dean, *Philosopher Kings*, *supra* note 137, at 958 (describing that, in the market for tax flight assets, if two states are close substitutes, assets would be shifted to the substitute state if the other state entered into a bilateral treaty).

145. Morse, *supra* note 68, at 691.

146. *See* Dean, *Philosopher Kings*, *supra* note 140, at 958 (arguing that flight jurisdiction residents have two options: (1) to repatriate their assets in their home jurisdiction; or (2) the "more likely of the two if the remaining havens are close substitutes for the former haven . . . to relocate their assets to another haven"); *see also* Morse, *supra* note 68, at 726–27 ("The success of FATCA thus depends on the stickiness of global investment in U.S. securities.")

flight.[147] DTAs can minimize this incentive by granting credits or exemptions for a tax on items that would otherwise be taxed twice.[148] Some commentators maintain, however, that bilateral TIEAs, like the ones the United States has signed with numerous tax havens, have been of questionable efficacy.[149] TIEAs were designed to solve fundamental information asymmetry so as to make tax evasion more difficult.[150] There are, however, a number of inherent limitations, namely: (1) the US TIEAs currently in force operate under a request-only basis, meaning that the IRS would have to know the identity of the suspected tax evader prior to the treaty request; and (2) these TIEAs typically do not require that a signatory country override its domestic laws, enact new laws, or create databases that do not already exist.[151] Lee Sheppard, of the nonprofit group Tax Analysts, has gone so far as to assert that "TIEAs were designed not to work."[152] As the UBS scandal demonstrated, request-only

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147. *See supra* notes 49–54 and accompanying text (clarifying how DTAs can be used to minimize tax flight); *supra* notes 76–80 (providing a description of TIEAs, where taxpayers would not engage in tax flight if the IRS would have information of their offshore accounts).

148. *See* Curtin, *supra* note 41, at 35 (detailing the mechanics of DTAs); *see also* Dean, *More Cooperation*, *supra* note 43, at 145 (arguing that DTAs take "two tax regimes that are similar and refine those similarities").

149. *See* Dean, *Incomplete Market*, *supra* note 61, at 650 (maintaining that although the TIEAs have enjoyed some success, they have failed to "provide a silver bullet for the tax flight problem"); *see also* Yates et. al., *supra* note 20, at 53 (arguing that, while many countries have rushed to enter into TIEAs, their effectiveness is uncertain).

150. *See* Dean, *Incomplete Market*, *supra* note 61, at 650–51 (describing stand-alone TIEAs as "symmetrical agreements, giving each country access to information from the other, [though] access to extraterritorial tax information was much more important to the United States than to its potential counterparties"); *see also* Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 STAN. L. REV. 695, 697–99 (2007) (noting that information reporting systems are "highly successful at securing compliance").

151. *See* Yates et al, *supra* note 20, at 53–54 (providing an example of the level of specificity needed to effect a treaty request); *see also* Nick Gregory, *Lax Tax: The Threat of Secrecy Jurisdictions and What the International Community Should Do About It*, 20 TRANSNAT'L L. & CONTEMP. PROBS. 859, 880 (2012) (explaining that, in essence, a TIEA would not lead to information that the US would not already know); *see also* JANE G. GRAVELLE, CONG. RESEARCH SERV., R40623, TAX HAVENS: INTERNATIONAL TAX AVOIDANCE AND EVASION 22 (2013) (providing the example that even if the British Virgin Islands, a "country with more than 400,000 registered corporations, where laws require no identification of shareholders or directors, and require no financial records" signed a TIEA, it would be unclear as to what information could actually be exchanged).

152. Sheppard, *supra* note 68, at 255.

information exchange agreements can be inadequate when the requestor does not know, with any level of specificity, the name of the taxpayer it wishes the receiver to produce.[153]

While, as Professor Rosenzweig has argued, multilateral agreements could limit non-cooperation between havens and non-havens, the success of these potential solutions in preventing tax arbitrage depends on overcoming a holdout problem.[154] As Professor Dean clarifies, assuming that US taxpayers can "easily substitute another jurisdiction in their tax avoidance schemes, then entering into TIEAs or tax flight treaties with fewer than all potential substitute jurisdictions simultaneously would be futile."[155] Although he qualifies this assertion by maintaining that there is reason to believe that not all jurisdictions act as "easy" substitutes for one another, nevertheless, the "threat of holdouts in this context remains significant."[156] Thus, countries that have not yet entered into TIEAs might be less incentivized to do so if holding out could mean that assets would be diverted from a newly compliant "haven" and into the holdout jurisdiction.[157]

To illustrate, assume that the United States has entered into three TIEAs with tax havens, Countries B, C, and D. If these are

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153. *See* Spencer, *Major Advance*, *supra* note 64, at 14 (arguing that, as a practical matter, tax haven jurisdictions cannot engage in automatic exchange because they do not obtain tax information from residents and therefore do not have the information to automatically exchange); *see also* Zagaris, *Sticks and Carrots*, *supra* note 69, at 341 (noting the procedural difficulties of receiving information that a tax haven would not ordinarily collect).

154. *See* Dean, *More Cooperation*, *supra* note 43, at 160 (maintaining that states seeking to bargain will be subject to the holdout problem); *see also* Rosenzweig, *International Arbitrage*, *supra* note 23, at 583–86 (arguing that this holdout problem disincentivizes bilateral and multilateral treaty formation).

155. Dean, *More Cooperation*, *supra* note 43, at 160.

156. *See* Avi-Yonah, *supra* note 4, at 1584 n.27 (noting that because one holdout is sufficient to create a haven, TIEAs have proven ineffective); *see also* Rosenzweig, *International Arbitrage*, *supra* note 23, at 585–86 ("As each additional country agrees to a multilateral solution preventing tax arbitrage, it becomes increasingly beneficial to the remaining countries to holdout from the agreement.")

157. *See* Rosenzweig, *Tax Havens*, *supra* note 136, at 952 (explaining the outcome of a game between two non-haven countries and one haven country that needs to attract capital to meet its minimum tax base); *see also* Gregory, *supra* note 151, at 886 ("If any one country were to end its privacy policies it would lose out on capital flow and funds would be diverted to other countries that maintain secrecy jurisdictions. In this sense, there is a perverse incentive not to become more transparent but rather to be the last secrecy jurisdiction standing.")

the only three tax havens in the world, then absent other considerations, there is little reason for a US citizen to move his or her assets to an FFI in Country B, C, or D if the United States will have knowledge of the transaction and tax it identically. Contrastingly, assume that the United States has entered into the same three TIEAS, but there are now six tax havens, Countries B, C, D, E, F, and G. Individuals now have the opportunity to invest their money at more favorable rates if they avoided Countries B, C, and D. Furthermore, Countries E, F, and G now have less of an incentive to enter into a TIEA. FFIs located within these countries similarly have less of an incentive to enter into a FATCA agreement because the assets from Countries B, C, and D would likely be diverted to the FFIs located in Countries E, F and G, allowing them to benefit from the tax revenues generated by the new investment. Even in a multilateral agreement, this holdout problem may be pervasive: it becomes increasingly beneficial for countries to holdout from joining in the multilateral efforts to prevent international tax arbitrage.[158]

2. Tax Flight Treaties: Overcoming Potential Holdouts

As a potential solution to FATCA's shortcomings, Professors Dean and Rosenzweig propose that a tax flight treaty could serve to potentially alleviate many of the problems posed by holdouts by aligning the incentives of tax havens with that of non-haven jurisdictions.[159] Following Professor Dean's model, a tax flight treaty would consist of: (1) a tax haven committing to develop the information infrastructure that would permit it to fully participate in the "exchange-of-information net" that source countries require to enforce their tax regimes; and (2) in exchange, the flight jurisdiction could agree to pay the

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158. *See* Dean, *More Cooperation, supra* note 43, at 160–61 (detailing how substitutability can affect individual taxpayer choices); *see also* Rosenzweig, *International Arbitrage, supra* note 23, at 584–86 (arguing that, while multinational cooperation might alleviate some of the deficiencies of bilateral treaties, they still suffer from a "substantial" holdout problem).

159. *See* Dean, *Philosopher Kings, supra* note 137, at 957–58 (arguing that a tax flight treaty offers a "new alternative" that could prove effective in reducing tax flight); *see also* Rosenzweig, *Tax Havens, supra* note 136, at 985 n.217 (providing further explanation of Professor Dean's tax flight model).

cooperating tax haven with a portion of the additional tax revenues generated by that haven's compliance.[160]

Professor Rosenzweig has further argued that by offering havens the tax revenue generated from resolving a specific tax dispute, it could better incentivize cooperation.[161] Thus, he asserts that cooperation can be gained by first identifying a "prize" to induce compliance.[162] This prize can serve as the haven's revenue under a tax flight treaty, which can be "Pareto superior to a world with an undersupplied public good," i.e. extraterritorial tax information.[163] In this way, for the "first time in the rise of the modern international tax regime," tax havens can directly benefit from joining their non-haven global counterparts.[164] Tax havens sheltering the most assets therefore receive the most compensation.[165]

D. *The Global Impact of the FATCA Regime*

FATCA draws upon lessons of history and responds to the demonstrated failures of the current tax system under Qualified Intermediary Agreements, Double Taxation Agreements, and

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160. See Dean, *Philosopher Kings*, *supra* note 137, at 957–58 (arguing that because the amount of revenue lost to tax flight relative to the size of a typical haven, "the tax flight treaty would be a perfect fit"); *see also* Julie Roin, *Can the Income Tax Be Saved? The Promise and Pitfalls of Adopting Worldwide Formulary Apportionment*, 61 TAX L. REV. 169, 187 n.55 (2008) (describing Professor Dean's theory as buying off tax havens).

161. *See* Dean, *Philosopher Kings*, *supra* note 137, at 958 (noting that, at first, this quid pro quo might seem "perverse, as though tax havens are being rewarded for bad behavior"); *see also* Rosenzweig, *Tax Treaty*, *supra* note 140, at 726 (describing one compliance mechanism as: letting poorer countries keep the benefits of a specific taxpayer dispute in exchange for an agreed upon set of baseline rules).

162. *See* Rosenzweig, *Tax Treaty*, *supra* note 140, at 726 (explaining that, in the aggregate, the lottery is the "single pool of uncollected tax revenue," or, essentially, the global tax gap).

163. *See* Rosenzweig, *Tax Treaty*, *supra* note 140, at 726 (explaining that the trick is to "find something to serve as the prize").

164. *See* Rosenzweig, *Tax Treaty*, *supra* note 140, at 727; *see also* Tyler J. Winkleman, *Automatic Information Exchange as a Multilateral Solution to Tax Havens*, 22 IND. INT'L & COMP. L. REV. 193, 210–11 (2012) (demonstrating the benefit of revenue sharing as opposed to outright buying of the tax information).

165. *See* Rosenzweig, *Tax Treaty*, *supra* note 140, at 756 (describing the lottery mechanism as "making it more appealing for nonmembers to join"); *see also* Winkleman, *supra* note 164, at 210–11 (explaining that the lottery system would disincentivize noncompliance).

Tax Information Exchange Agreements.[166] Scholars note that information asymmetry will always exist if, in the end, the necessary information cannot be obtained from the individual taxpayers or overseas banks.[167] But, FATCA represents an abandonment of the United States' previous policy of negotiating with countries and attempting to sign DTAs or TIEAs, instead dealing directly with FFIs first and forcing countries interested in remaining in US markets to negotiate.[168]

1. The FATCA Method of Entering the Information Market

FATCA may solve the problems posed by information asymmetry by forcing FFIs to internalize the cost of this asymmetry.[169] FFIs will now be subject to extensive information reporting requirements.[170] Not only will FFIs need to identify their US accountholders, but FATCA also requires FFIs to report annually on gross receipts and gross payments throughout the life of the account.[171] Required automatic reporting, according to the IRS, reduces some of the ineffectiveness of request-only information exchange agreements, especially as they pertain to countries that otherwise would not collect such information in the first place, notably, tax havens.[172]

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166. *See* Yates et al, *supra* note 20, at 55–56 (describing the "questionable effectiveness" of TIEAs); *see also* REP. ON TAX HAVEN BANKS, *supra* note 76 (explaining UBS was able to exploit deficiencies in the QI system and those inherent in DTAs and TIEAs with countries with stricter bank secrecy laws).

167. *See* Lederman, *Reducing Information Gaps*, *supra* note 128, at 1733 (addressing the issue of information asymmetry); *see also* Samantha H. Scavron, *In Pursuit of Offshore Tax Evaders: The Increased Importance of International Cooperation*, 9 CARDOZO PUB. L. POL'Y & ETHICS J. 157, 183 (2010) (explaining that finding out information is a "pivotal step" for the IRS, but is useless if, in the end, the IRS has no way of obtaining the necessary evidence).

168. *See* 26 U.S.C. § 1471(a) (2012) (providing an overview of the reporting requirements); *see also supra* notes 83–86 and accompanying text (discussing the refusal of the Swiss Federal Administrative Court as a poignant example of why governments with disparate banking laws could be difficult to work with).

169. *See* Lederman, *Reducing Information Gaps*, *supra* note 128, at 1733 (explaining that information reporting schemes force the private parties required to report to internalize the cost); *see also* Scavron, *supra* note 167, at 178–84 (outlining the various unilateral methods for gathering information).

170. § 1471(c).

171. *Id.*

172. *See* Farag, *supra* note 132, at 5 (arguing that FATCA gives the IRS the tools to crack down on tax evasion by requiring FFIs to report account information directly to the IRS); *see also* Yates et al., *supra* note 20, at 55–56 (noting that FATCA's enhanced

FATCA has also been successful in sparking an influx of voluntary disclosures.[173] Although FATCA's most sweeping provisions are set to gradually phase in between 2013 to 2018, the success of the 2009 and 2011 voluntary disclosure programs and the threat of "beefed up" enforcement posed by third party reporting has led the IRS to enact an open-ended offshore voluntary disclosure program.[174] To entice disclosure, the party that "speaks up first is key. If the IRS has any details, it's too late to get the [OVDI] package deal."[175] Already the IRS has announced that its disclosure programs have yielded more than US$5 billion in recovered tax revenue, far in excess of its expectations.[176]

FATCA has further prompted the widespread creation of new FATCA-compliant intergovernmental agreements ("IGAs").[177] In July 2012, the US Treasury Department

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and mandatory disclosure requirements "ease the government's burden in prosecuting tax cases involving offshore compliance").

173. *See* TIGTA REPORT, *supra* note 108 (illustrating the success of the program thus far); *see also* Jeremy Tempkin, *Offshore Voluntary Disclosure Part III – Yet Another Last Chance for Taxpayers*, FORBES (Jan. 11, 2012, 11:37 AM), http://www.forbes.com/sites/insider/2012/01/11/offshore-voluntary-disclosure-part-iii-yet-another-last-chance-for-taxpayers/ (reporting the IRS's third OVDI resulting from the success of the previous programs); *see also 2012 Offshore Voluntary Disclosure Program*, INTERNAL REVENUE SERV., http://www.irs.gov/uac/2012-Offshore-Voluntary-Disclosure-Program (last visited Aug. 22, 2013) (providing an outline of the to-date success of the programs with case studies).

174. *See* I.R.S. News Release IR-2012-64 (June 26, 2012) (providing the IRS's explanation as to the success of the program thus far); *see also* Tempkin, *supra* note 173 (noting that, regardless of their motives for not "coming clean" in the first two programs, taxpayers with undisclosed assets can still enter the program). On July 12, 2013, the IRS and DOJ again changed the compliance timelines to reflect comments received expressing practical difficulties with FATCA's implementation. *See* I.R.S. Notice 2013-43.

175. Robert W. Wood, *FATCA Cliff: Tax Evasion Guilty Plea and Death for Oldest Swiss Bank*, FORBES (Jan. 3, 2013, 11:06 PM), http://www.forbes.com/sites/robertwood/2013/01/03/global-banking-cliff-fatca-irs-guilty-plea-and-death-for-oldest-swiss-bank/ (adding that the IRS and DOJ are coming into a "goldmine of data" from bank deals and whistleblowers).

176. I.R.S. News Release, *supra* note 174 (reporting 33,000 voluntary disclosures under the first two programs); *see also* Tempkin, *supra* note 173 (outlining the success of the first two programs).

177. *See* Press Release, U.S. Dep't of Treasury, U.S. Engaging with More than 50 Jurisdictions to Curtail Offshore Tax Evasion (Nov. 8, 2012), *available at* http://www.treasury.gov/press-center/press-releases/Pages/tg1759.aspx (reporting that the Treasury Department is "continuing to build" international support for FATCA); *see also* Keith Lawson, *How the Model Intergovernmental Agreement Reduces*

published a model intergovernmental agreement to implement the withholding and reporting requirements that FATCA demands.[178] France, Germany, Spain, and the United Kingdom endorsed the model agreement, and called for a "speedy conclusion of bilateral agreements based on the model."[179] The US Treasury Department has since announced that it has been engaging with more than fifty jurisdictions to help combat offshore tax evasion through FATCA's implementation.[180]

2. The Cost of International Cooperation

The most common objection to FATCA has been the cost of compliance.[181] As the Big Four accounting firm KPMG has pointed out, while the requirements are "simple in concept," they are difficult and costly to implement.[182] According to some experts, it is entirely possible that the costs associated with FATCA compliance may be higher than the resulting revenue gained.[183] One consulting firm estimated that compliance costs

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FATCA Burdens, INVEST. CO. INST. (Aug. 1, 2012), http://www.ici.org/viewpoints/view_12_fatca_iga (illustrating some of the features of the FATCA Intergovernmental Agreements ("IGAs")).

178. *See* Press Release, U.S. Dep't of Treasury, Treasury Releases Model Intergovernmental Agreement for Implementing the Foreign Account Tax Compliance Act to Improve Offshore Tax Compliance and Reduce Burden (July 26, 2012) [hereinafter Model IGA Press Release], *available at* http://www.treasury.gov/press-center/press-releases/Pages/tg1653.aspx (reporting on the FATCA IGA progress made by the IRS); *see also* Lawson, *supra* note 177 (explaining the features of the IGA).

179. Model IGA Press Release, *supra* note 178.

180. *See id.* (announcing the IRS's efforts to enter into agreements with as many other nations as possible); *see also* Memorandum from Keith Lawson, Senior Counsel, Inv. Co. Inst., to Tax Members et al. (July 26, 2012), *available at* http://www.ici.org/ops/fund_dist/ci.memo26344.print (detailing specific sections of the FATCA IGAs).

181. *See FATCA – Compliance Costs and Risks*, KPMG (Nov. 1, 2012), http://www.kpmg.com/us/en/issuesandinsights/articlespublications/taxnewsflash/pages/fatca-compliance-costs-and-risks.aspx [hereinafter KPMG Report] (illustrating FATCA's price tag); *see also* Robert W. Wood, *FATCA Carries Fat Price Tag*, FORBES (Nov. 30, 2011, 6:12 AM), http://www.forbes.com/sites/robertwood/2011/11/30/fatca-carries-fat-price-tag/ (estimating that compliance costs alone could cost financial institutions US$100 million).

182. *See* KPMG Report, *supra* note 181 (expressing doubt as to the financial viability of the program); *see also* Dean, *Incomplete Market*, *supra* note 61, at 605–06 (noting that governments often do not pay for the tax information they require).

183. *See* Robert W. Wood, *More Bad News for FATCA*, FORBES (July 17, 2012, 11:45 PM), http:// www. forbes.com/sites/robertwood/2012/07/17/more-bad-news-for-fatca/ (declaring that this argument was "hard to miss"); *see also Foreign Account Tax Compliance Act (FATCA) Executive Summary*, DELOITTE (2012),

might be between US$150 million and US$200 million for every medium-sized bank.[184]

Although the IRS has reportedly rejected the possibility of substantial capital flight, this may not be entirely realistic.[185] Capital flight to Asia might be a potentially serious problem.[186] For example, UBS in Switzerland has lost approximately US$200 billion worldwide in assets from private banking over the last two years.[187] In Asia, however, UBS has gained more assets due to capital inflow than it has lost due to capital flight.[188] Amid this growing crackdown on tax evasion, "the rich are flocking to Singapore and Hong Kong," which offer very attractive banking incentives.[189] While in "active dialogue" with Singapore, the United States currently has a very limited tax treaty with

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http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_FATCA_Executive_Summary_112812.pdf (finding that FATCA is projected to raise US$7.6 billion over a ten year period).

184. *See* Ann Hollingshead, *You Do the Math: Adding Up the Costs of Complying with FATCA*, FIN. TRANSPARENCY COALITION (Sept. 28, 2011), http://www.financialtransparency.org/2011/09/28/you-do-the-math-adding-up-the-costs-of-complying-with-fatca/ (detailing a number of opinions as to the projected costs of compliance); *see also FATCA: Will Thailand Enter Intergovernmental Agreement with US?*, NATION (Thailand) (Jan 31, 2013, 1:00 AM), http://www.nationmultimedia.com/business/FATCA-Will-Thailand-enter-intergovernmental-agreem-30199055.html (reporting that the cost of creating a FATCA compliant system for large diversified financial institutions would be in the "many millions" of US dollars); Morse *supra* note 68, at 726 ("[O]n the margin, some banks might divest U.S. assets.").

185. *See* Susan C. Morse, *Ask For Help, Uncle Sam: The Future of Global Tax Reporting*, 57 VILL. L. REV. 529, 547 n.105 (2012) [hereinafter Morse, *Uncle Sam*] (explaining that the IRS has dismissed these claims, but noting that a 2004 study found that a weaker version of a similar regulation would cause US$88 billion in capital flight); Von Daniel Mitchell & Brian Gurst, *The Janus Face of US Tax Policy*, SCHWEIZER MONAT (Swiss), http://www.schweizermonat.ch/artikel/the-janus-face-of-us-tax-policy (last visited Aug. 23, 2013) (theorizing that FATCA may backfire and drive capital away from the American economy).

186. *See* Emily Wang, Note, *The Opaque Future of Tax Information Between the United States and China: An Analysis of Bank Secrecy Laws and the Likelihood of Entrance into a Tax Information Exchange Agreement*, 35 HASTINGS INT'L & COMP. L. REV. 411, 425–26 (2012) (illustrating the potential for capital flight); *see also* Morse, *Uncle Sam*, *supra* note 185 (demonstrating that FATCA could likely produce capital flight).

187. *See* Lynnley Browning, *Seeking Bank Secrecy in Asia*, N.Y. TIMES, Sept. 23 2010, at B3 (reporting on the massive capital flight that Switzerland has experienced as a result of the DOJ probes of Swiss banks); *see also* Wang, *supra* note 186, at 425 (illustrating the capital flight that Switzerland has experienced).

188. *See* Browning, *supra* note 186, at B3 (referencing a presentation given by the bank's chief executive of wealth management, Jürg Zeltner); *see also* Wang, *supra* note 186 (illustrating why Asia is a prime location for capital inflow).

189. Browning, *supra* note 187, at B3.

Singapore, and no taxation treaties whatsoever with Hong Kong, which is its own Special Administrative Zone within China.[190]

Further, the Chinese government has recently stated that it would likely holdout from a FATCA agreement.[191] Currently, no countries from the Asia Pacific, a region some commentators maintain is heavily influenced by Beijing's policy decisions, have entered into IGAs.[192] Nigel Green, the CEO of a British financial advisory firm, has speculated that China will not sign an IGA because it would be difficult to implement due to its disparate legal system, and that the country "would—thanks to a laughable lack of reciprocity—benefit very little from it."[193] Based on both China's unwillingness to participate and what he calls the "fundamentally flawed" nature of FACTA, Mr. Green predicts that the FATCA project is "beginning to unravel."[194]

The combination of globalization and technological advances has had the effect of eroding many of the remaining barriers to international trade. This erosion, however, has put increasing pressure on the revenue of jurisdictions, like the United States, that seek to tax its citizens and resident aliens on worldwide income, a problem further exacerbated by the presence of tax havens. These tax havens provide the means by which individuals and business entities can engage in tax

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190. See Robert W. Wood, *U.S. Is Doing FATCA Deals With 50 Countries!*, FORBES (Nov. 13, 2012, 12:00 AM), http://www.forbes.com/sites/robertwood/2012/11/13/u-s-is-doing-fatca-deals-with-50-countries/ (listing Singapore as a nation in "active dialogue" with the DOJ); *see also Treaties in Force*, *supra* note 41 (listing all of the treaties currently in force).

191. Laura Saunders, *Offshore Tax Probe Picks Up*, WALL ST. J. (Mar. 6, 2013, 5:56 PM), http://online.wsj.com/article/SB10001424127887324034804578344280151020580.html (reporting that China was a "notable" holdout); *see also* Lisa Smith, *US Unlikely to Crack China FATCA Agreement*, IEXPATS (Mar. 4, 2013), http://www.iexpats.com/2013/03/us-unlikely-to-crack-china-fatca-agreement/ (noting that China has made clear that it is unlikely to comply with FATCA).

192. *See* Jonathan Boyd, *US FATCA Project 'Beginning to Unravel' Says deVere's Nigel Green*, INV. EUR. (Mar. 5, 2013), http:// www.investmenteurope.net/investment-europe/feature/2252325/us-fatca-project-beginning-to-unravel-says-deveres-nigel-green (arguing that the region is heavily influenced by China's economic and political power); *see also* Smith, *supra* note 191 (explaining that, while Japan was reportedly close, no other Asian country had yet reached a deal).

193. Boyd, *supra* note 192 (answering the question: "How likely is China not to sign an IGA with the US?").

194. *See id.* (arguing that FATCA's flaws might deter other governments from complying); *see also* Smith, *supra* note 191 (quoting a US consulting expert as saying that the "US has more incentive to sign the IGA than the Chinese government do").

arbitrage. Congress passed FATCA in an attempt to prevent tax arbitrage through an automatic reporting system, which it hopes will decrease information asymmetry and increase taxpayer compliance. Implementation of FATCA, however, might not produce these desired results if it cannot overcome the strong incentive for havens not to comply.

III. *FATCA'S EFFECT ON EXTRATERRITORIAL TAX INFORMATION*

Part III analyzes FATCA's effectiveness in addressing the issues of information asymmetry and international tax arbitrage. Part III.A examines the ways in which FATCA might reduce tax arbitrage in light of the demonstrated weaknesses of the international tax treaty system. Part III.B argues that FATCA, as a high-penalty tax regime, will ultimately fail in its stated purpose of diminishing tax evasion because noncompliance would likely produce a higher payoff than compliance. Finally, Part III.C recommends that, in place of FATCA, the United States should adopt a tax flight treaty to align the interests of potential noncompliant countries with that of the United States.

A. *How FTCA Advances the Fight Against Tax Evasion*

The international tax treaty system is rife with opportunities for both individual taxpayers and financial institutions alike to evade taxes.[195] As the size of the tax gap suggests, the United States has been unable to overcome information asymmetry under these traditional tax treaties.[196] No example is more representative of this institution-wide practice of exploitation than the UBS scandal.[197]

MLATs are virtually useless in the prosecution of tax evaders.[198] TIEAs could be effective in the absence of information asymmetry. They are not, however, because the

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195. *See supra* notes 87–90 and accompanying text (describing how the current DOJ investigations into Swiss banks exemplify the types of opportunities available to tax arbitrageurs).

196. *See supra* notes 7–9 and accompanying text (addressing the tax gap).

197. *See supra* notes 74–78 and accompanying text (describing the UBS scandal).

198. *See supra* notes 57–59 and accompanying text (discussing the major shortcomings of the use of MLATs).

nations with which the United States currently has TIEAs do not ordinarily collect the tax information sought.[199] Article 26 of the OECD Model Treaty, incorporated into many DTAs, has proven to be ineffective because, in many instances, the United States did not know enough information about the taxpayer to effect a treaty request.[200]

FATCA will make tax evasion significantly more difficult by taking giant steps in reducing information asymmetry.[201] As exemplified by UBS and Switzerland, but applicable with nearly every tax haven, it is exceedingly difficult to detect and prosecute tax cheats without first having sufficient information about the taxpayer.[202] FATCA's automatic information reporting helps alleviate this problem by shifting the task, and, conveniently, the cost, away from the IRS and on to the FFI.[203] Furthermore, by engaging directly with FFIs who have significant financial stakes in US markets, FATCA's required waiver of any non-US law that would prohibit compliance significantly helps enforcement, and has sent many countries to the bargaining tables to sign IGAs.[204]

The imminent implementation of FATCA has spurred a whirlwind of behavioral changes that have increased, and will continue to increase, US tax compliance.[205] With the threat of FATCA looming, and through the multiple voluntary disclosure programs, thousands are already flocking back to the US tax system with the promise of amnesty.[206] Although far from revolutionary, the US$5 billion recovered through voluntary

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199. *See supra* notes 68–73 and accompanying text (detailing how ineffective TIEAs can be in practice).

200. *See supra* notes 83–86 and accompanying text (explaining how Switzerland nearly set up an impenetrable wall using the Swiss-DTA).

201. *See supra* notes 68–69 and accompanying text (noting the effectiveness of automatic versus request-based information exchange).

202. *See supra* notes 72–73 and accompanying text (demonstrating this point using TIEAs).

203. *See supra* notes 169–72 and accompanying text (describing how the cost of compliance is shifted to FFIs).

204. *See supra* notes 123–24 and accompanying text (noting the waiver requirement); *supra* notes 177–80 and accompanying text (reporting the progress made with IGAs).

205. *See supra* notes 105–07 and accompanying text (describing a recent change in behavior regarding tax compliance).

206. *See supra* notes 111–13 and accompanying text (analyzing the effectiveness of the voluntary disclosure programs).

disclosure is a positive step towards eliminating the tax gap.[207] Moreover, as exemplified by the investigations into numerous Swiss banks, the worldwide attitude towards tax evasion seems to be changing in favor of compliance and disclosure.[208]

B. *Why FATCA Comes Up Short*

As a high-penalty, high-cost tax regime, FATCA does little to solve the holdout problem inherent in any bilateral agreement aimed at controlling tax arbitrage.[209] Tax arbitrage will continue to exist so long as the costs of the arbitrage, i.e. relocation of assets, do not outweigh the benefits, i.e. avoided tax liability.[210] Any actor who determines that the costs of compliance exceed the benefit of non-cooperation will exit the FATCA scheme immediately.[211]

There is reason to believe that many FFIs have such a large financial stake in US securities that it would be financially disastrous for them to exit that market. It would be wrong to assume, however, that, under Professor Morse's framework, compliant FFIs and nations are not close substitutes for their noncompliant counterparts.[212] If it is true that many FFIs and countries, particularly havens, are close substitutes for each other, then FATCA's high-penalty regime would not deter the penalized behavior in such a way that it would in the absence of these substitutes.[213] The existence of these substitutes perpetuates tax arbitrage as a rational and practicable option.[214]

207. *See supra* note 176 and accompanying text (demonstrating how voluntary disclosure can produce real results in the elimination of the federal tax gap).

208. *See supra* notes 113, 177–80 and accompanying text (reflecting this new attitude with the DOJ investigations and recent IGAs).

209. *See supra* note 154 and accompanying text (illustrating the holdout problem of bilateral agreements).

210. *See supra* notes 136–37 and accompanying text (examining why tax arbitrage takes place).

211. *See supra* note 184 and accompanying text (identifying total asset divestiture as within contemplation).

212. *See supra* notes 143–46 and accompanying text (discussing the consequences of the presence of close substitutes).

213. *See supra* notes 143–46 and accompanying text (arguing that high-penalty regimes cannot be successful without the absence of the option of substitution).

214. *See supra* notes 157–58 and accompanying text (demonstrating how the existence of substitutes facilitates tax arbitrage).

FATCA's automatic reporting requirements would certainly provide the IRS with a treasure trove of tax information, but its onerous compliance costs might incentivize both FFIs and nations to hold out and reap the benefit of other players' cooperation.[215] In bilateral agreements, such as a FATCA, FFI Agreement, or an IGA, the payoff of non-cooperation could easily exceed the costs of cooperation.[216] Thus, as each FFI and nation signs FATCA agreements and IGAs, it becomes increasingly beneficial for other FFIs and nations not to sign these agreements so as to enjoy the benefits of increased tax revenue from newly-relocated assets.[217] So long as the cost of compliance remains high and other options remain available, the current FATCA model cannot overcome this incentive for non-cooperation.[218]

Faced with the incentive to holdout, FATCA may actually do more harm than good to the United States. Capital flight towards non-cooperative FFIs and countries would likely have an adverse effect on US capital markets.[219] Tax evaders would be responsible for a substantial part of this capital flight by relocating their assets to non-FATCA jurisdictions.[220] For smaller FFIs, however, on the cusp of deciding whether to comply, withhold, or divest, asset divestiture would similarly result in capital flight.[221] As is evidenced by China's recent stance on signing a FATCA IGA, there is a strong reason to believe that Asia is prime location for capital inflow.[222] Hong Kong

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215. *See supra* notes 154–57 and accompanying text (describing the holdout incentive).

216. *See supra* notes 157–58 (applying the holdout incentive to bilateral agreements).

217. See supra notes 157–58 and accompanying text (illustrating the payoffs of non-cooperation).

218. *See supra* notes 154–57 and accompanying text (analyzing the holdout problem in a tax arbitrage context); *see also supra* notes 181–84 and accompanying text (examining the cost consequence of FATCA).

219. *See supra* note 146 (noting that the success of FATCA would depend on the "stickiness" of US capital markets).

220. *See supra* notes 185–90 and accompanying text (describing the likelihood of capital flight as a result of FATCA).

221. *See supra* note 184 and accompanying text (detailing the possibility of total asset divestiture in response to FATCA).

222. *See supra* notes 191–94 and accompanying text (outlining China's stance on FATCA, and noting that the Asia Pacific region is heavily influenced by the policy decisions of China).

represents the exact type of close substitute that has very little reason to comply with FATCA and every incentive to reap the benefits of non-cooperation.[223]

C. *How to Achieve Information Symmetry*

The US Congress enacted FATCA amid significant popular animosity towards financial institutions perceived as helping US citizens evade taxes, as well as toward havens facilitating this evasion. The history surrounding its enactment notwithstanding, the crucial question that remains is whether FATCA was indeed the right solution. FACTA has caused a significant backlash from FFIs and nations that see it as an imposition of imperious US tax policy. As a result, it may ultimately do little to achieve its stated goal of raising revenue to close the tax gap.[224] Further, FATCA would not reduce the present information asymmetry if taxpayers and FFIs simply shifted their assets out of the United States, and, more importantly, outside of United States' jurisdiction.[225]

FATCA's purposes would be better accomplished if it were replaced with a tax flight treaty.[226] Tax flight treaties reverse the incentive to holdout from bilateral agreements by establishing a prize for which to compete.[227] The prize here would be some percentage of the assets of the US tax cheats that tax flight treaty compliant nations voluntarily hand over to the IRS.[228] Under this approach, the longer a nation waits before entering into the agreement, the less likely it is that there will be US taxpayers to divulge, and the less likely it would be to win an enviable prize.[229] Unlike the FATCA method, the havens with the most

223. *See supra* notes 191–94 and accompanying text (outlining China's stance on FATCA).

224. *See supra* notes 184–89 and accompanying text (discussing some of the global effects of FATCA).

225. *See supra* notes 185–89 and accompanying text (illustrating withdrawal from US markets).

226. *See supra* notes 160–65 and accompanying text (arguing that tax flight treaties can reverse the holdout incentive in bilateral agreements).

227. *See supra* notes 163–65 and accompanying text (explaining how tax flight treaties establish a prize to induce compliance).

228. *See supra* notes 160–65 and accompanying text (detailing how the lottery system of tax flight treaties operate).

229. *See supra* notes 159–60 and accompanying text (illustrating how tax flight treaties reverse holdouts).

assets held by US tax evaders have the most incentive to cooperate.[230] Thus, the United States could pay its way into the market for tax information and benefit from competition between nations for compliance without driving investment and information away from the United States.[231]

CONCLUSION

Tax evasion is a global problem that requires global cooperation. The current tax treaty models, however, have proven incapable of incentivizing multilateral cooperation to tackle the issue. While the United States has spearheaded a resolution through the enactment of FATCA, pursuing a FATCA regime is not in the nation's best interest and is not a viable solution.

Taxpayers and investors who weigh the costs and benefits of any market transaction will come to realize that participating in a FATCA agreement is uneconomical and shift their assets to lower tax-liability jurisdictions. Similarly, governments presented with the option to sign an IGA should think twice about signing such an agreement, or risk forfeiting the potential to acquire new, inbound capital. While this asset relocation could be overcome through the cooperation of every single nation, there is no incentive to cooperate if non-cooperation ensures a higher payout. Thus, so long as close substitutes are a viable possibility for any market transaction, which there almost certainly are, a high-penalty regime like FATCA will remain ineffectual. The United States should adopt a tax flight treaty. Tax flight treaties could force traditional havens to cooperate, and would have the effect of increasing taxpayer compliance, both voluntarily and involuntarily, by reducing extraterritorial tax information asymmetry. Unlike FATCA, these treaties could permanently rid the United States of tax evaders.

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230. *See supra* notes 160–65 and accompanying text (showing how the incentive to cooperate increases along with the amount of tax evaders' assets held by the country).

231. *See supra* notes 161–65 (overcoming the incentive to engage in tax arbitrage).

NOTES AND OBSERVATIONS