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The Battle Over Taxing Offshore Accounts

Itai Grinberg

ABSTRACT

The international tax system is in the midst of a contest between automatic information reporting and anonymous withholding models for ensuring that nations have the ability to tax offshore accounts. At stake is the extent of many countries' capacity to tax investment income of individuals and profits of closely held businesses through an income tax in an increasingly financially integrated world.

Incongruent initiatives of the European Union, the Organisation for Economic Cooperation and Development (OECD), Switzerland, and the United States together represent an emerging international regime in which financial institutions act to facilitate countries' ability to tax their residents' offshore accounts. The growing consensus that financial institutions should act as cross-border tax intermediaries represents a remarkable shift in international norms that has yet to be recognized in the academic literature.

The debate, however, is about how financial institutions should serve as cross-border tax intermediaries, and for which countries. Different outcomes in this contest portend starkly different futures for the extent of cross-border tax administrative assistance available to most countries. The triumph of an automatic information reporting model over an anonymous withholding model is key to (1) allowing for the taxation of principal, (2) ensuring that most countries are included in the benefit of financial institutions serving as cross-border tax intermediaries, (3) encouraging taxpayer engagement with the polity, and (4) supporting sovereign policy flexibility, especially in emerging and developing economies. This Article closes with proposals to help reconcile the emerging automatic information exchange approaches to produce an effective multilateral system.

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INTRODUCTION

Approximately $7.8 trillion, representing more than 6 percent of all global wealth, is managed through offshore accounts.[1] Beginning in 2008, well-publicized cross-border tax evasion scandals focused political attention on offshore tax evasion in the world's major economies. One of the major scandals involved the United Bank of Switzerland (UBS), one of Europe's largest banks. Another involved LGT, a bank controlled by the royal family of Liechtenstein. The details read like a thriller. Bankers smuggled toothpaste tubes full of diamonds across borders, while governments bought stolen disks that identified tax evaders and handed new identities to the informants.[2]

In the midst of the financial crisis, with its attendant budgetary pressures, the political response to the offshore tax evasion scandals was swift. Presidents and finance ministers insisted on improved transparency to combat offshore tax abuses. Recognizing its vulnerability to demands for transparency, Switzerland developed its own proposal: anonymous cross-border tax withholding in lieu of an information reporting scheme that would promote transparency.

Thus began a global contest between automatic information reporting and anonymous withholding models for ensuring that states have the ability to tax offshore accounts. The latest moves as of this writing came in February, April, June, and July of 2012.[3] In February, the governments of six large developed econ-

1. BOS. CONSULTING GRP., GLOBAL WEALTH 2011: SHAPING A NEW TOMORROW 13 (2011), *available at* http://www.bcg.com.pl/documents/file77766.pdf. For the purposes of this Article, wealth managed through offshore accounts means "assets booked in a country where the investor has no legal residence or tax domicile." *Id.*
2. Lynnley Browning, *Ex-UBS Banker Pleads Guilty in Tax Evasion*, N.Y. TIMES, June 20, 2008, at C1; Carter Dougherty & Mark Landler, *Tax Scandal in Germany Fans Claims of Inequity*, N.Y. TIMES, Feb. 18, 2008, at C8; *Liechtenstein Tax Evasion Scandal: Informant in German Investigation 'Fears' for His Life*, SPIEGEL ONLINE INT'L, Mar. 3, 2008, http://www.spiegel.de/international/business/0,1518,540283,00.html.
3. An earlier version of this Article first appeared on SSRN in January of 2012. Readers should view events after July 1, 2012 as generally beyond the scope of this Article. The author intends to address more recent events in a follow-up paper. Nevertheless, it is of note that since July 1, France, Germany, Italy, Spain, the United States, and the United Kingdom have issued a Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA, the United States and the United Kingdom have signed such a "FATCA agreement," the German Bundestag has held hearings on the Swiss–German anonymous withholding agreement, and the United States Treasury has announced that it is in discussions with more than fifty jurisdictions around the world regarding intergovernmental approaches to implement FATCA. *See* Press Release, U.S. Dep't of Treasury, U.S. Engaging With More Than 50 Jurisdictions to Curtail Offshore Tax Evasion (Nov. 9, 2012), http://www.treasury.gov/press-center/press-release/Pages/tg1759.aspx. *See, e.g.*, Agreement Between the Government of the United States of America and the Government of the

omies, including the United States, issued a joint statement contemplating a shared commitment to developing a common model for the automatic exchange of tax information and reaffirmed that commitment in a model intergovernmental agreement issued over the summer.[4] In April, treaty protocols entered into by Germany and the United Kingdom with Switzerland and a new agreement between Austria and Switzerland affirmed those countries' interests in anonymous withholding by the Swiss.[5] In June, Switzerland and the United States issued a joint statement that defused the direct confrontation between the two countries over U.S. legislation generally requiring non-U.S. financial institutions to report

United Kingdom of Great Britain and Northern Ireland to Improve International Tax Compliance and to Implement FATCA, U.S.–UK, Sept. 12, 2012, *available at* http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Agreement-UK-9-12-2012.pdf; 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: Agreement Developed With France, Germany, Italy, Spain and the United Kingdom Marks Important Milestone in Combatting Offshore Tax Evasion (July 26, 2012), http://www.treasury.gov/press-center/press-releases/Pages/tg1653.aspx; *Finanzausschuss Anhörungen: Umsetzungsgesetz zum Abkommen Deutschland–Schweiz (BT-Drs. 17/10059): Stellungnahmen* [*Finance Committee Hearings: Implementation Act for the Germany–Switzerland Treaty (BT-Drs. 17/10059): Opinions*], BUNDESTAG, http://www.bundestag.de/bundestag/ausschuesse17/a07/anhoerungen/2012/098/Stellungnahmen/index.html (last visited Oct. 30, 2012). These events do not alter the basic thrust of the argument.

4. *See* Press Release, U.S. Dep't of Treasury, Joint Statement From the United States, France, Germany, Italy, Spain and the United Kingdom Regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA (Feb. 7, 2012), http://www.treasury.gov/press-center/press-releases/Documents/020712 Treasury IRS FATCA Joint Statement.pdf [hereinafter Joint Statement I]; MODEL INTERGOVERNMENTAL AGREEMENT TO IMPROVE TAX COMPLIANCE AND TO IMPLEMENT FATCA (2012), *available at* http://www.treasury.gov/press-center/press-releases/Documents/reciprocal.pdf [hereinafter MODEL INTERGOVERNMENTAL AGREEMENT].

5. Protokoll zur Änderung des am 21. September 2011 in Berlin unterzeichneten Abkommens zwischen der Schweizerischen Eidgenossenschaft und der Bundesrepublik Deutschland über Zusammenarbeit in den Bereichen Steuern und Finanzmarkt [Protocol Amending the Agreement Between the Swiss Confederation and the Federal Republic of Germany on Cooperation in the Area of Taxation and Financial Markets Signed in Berlin September 21, 2011], Ger.–Switz., Apr. 5, 2012 (Ger.), *available at* http://www.news.admin.ch/NSBSubscriber/message/attachments/26526.pdf [hereinafter Ger.–Switz. Protocol Amendment]; Protocol Amending the Agreement Between the United Kingdom of Great Britain and Northern Ireland and the Swiss Confederation on Cooperation in the Area of Taxation, U.K.–Switz., Oct. 6, 2011, *available at* http://www.hmrc.gov.uk/taxtreaties/protocol-amend-ukswiss-agree.pdf [hereinafter U.K.–Switz. Protocol Amendment]; Abkommen zwischen der Schweizerischen Eidgenossenschaft und der Republik Österreich über die Zusammenarbeit in den Bereichen Steuern und Finanzmarkt [Agreement Between the Swiss Confederation and Austria on Cooperation in the Area of Taxation and Financial Markets], Austria–Switz., Apr. 13, 2012 (Ger.), *available at* http://www.news.admin.ch/NSBSubscriber/message/attachments/26559.pdf [hereinafter Austria–Switz. Cooperation Agreement].

information on accounts held by U.S. persons,[6] while allowing the broader contest between anonymous withholding and automatic information exchange to play out.

The outcome of the debate over whether automatic information reporting or anonymous withholding should prevail will affect states' abilities to tax their wealthiest residents' income. The capacity to make, hold, and manage investments through offshore financial institutions[7] has increased dramatically in recent years, while the cost of such services has plummeted.[8] Individuals now find it substantially easier to underreport or not to report investment earnings through the use of offshore accounts, and experience suggests that such accounts may also be used to help closely held businesses evade tax on income earned domestically. Consequently, the principal held in offshore accounts and the investment earnings generated through such accounts may go untaxed.

Under either an automatic information reporting or an anonymous withholding model for cross-border tax administrative assistance, global financial institutions are co-opted by governments as cross-border tax intermediaries. In this important respect, the two models are variants of a single emerging regime. However, the contest between information reporting and anonymous withholding models for how financial institutions will provide cross-border tax administrative assistance implicates broad questions about the future of tax sovereignty in a globalized economy and about the treatment of the wealthiest vis-à-vis other taxpayers. Whereas anonymous withholding delegates tax collection to a foreign entity, automatic information reporting shores up a government's capacity to tax its own citizens.

The stakes in the battle between automatic information exchange and anonymous withholding are particularly high for many emerging and developing econ-

6. Press Release, U.S. Dep't of Treasury, U.S. & Switz., Joint Statement From the United States and Switzerland Regarding a Framework for Cooperation to Facilitate the Implementation of FATCA (June 21, 2012), http://www.treasury.gov/press-center/press-releases/Documents/FATCA Joint Statement US-Switzerland.pdf [hereinafter Joint Statement II]. See Part II.B.3, *infra*, for a full discussion of this legislation, commonly known as "FATCA."

7. I use the term "offshore financial institution" to refer to any financial institution outside a given investor's jurisdiction of legal residence or tax domicile. This use of the term "offshore financial institution" differs from much of the literature regarding "offshore financial centers." That literature tends to categorize individual jurisdictions as "onshore" and "offshore" centers. *See, e.g.*, Andrew K. Rose & Mark M. Spiegel, *Offshore Financial Centres: Parasites or Symbionts?*, 117 ECON. J. 1310 (2007). In contrast, I view a financial institution in the United Kingdom serving an Indian investor as an "offshore financial institution" with respect to that Indian investor.

8. Maintaining the capacity for large, developed economies to tax capital income under such circumstances has been a subject of scholarly concern for many years. *See, e.g.*, Vito Tanzi, *Globalization, Technological Developments, and the Work of Fiscal Termites*, 26 BROOK. J. INT'L L. 1261, 1262, 1274–75 (2001).

omies. For these countries, the question is not whether their wealthy taxpayers' access to offshore accounts will weaken enforcement but whether, given such access, taxes on capital income can be enforced at all. In many such economies, a concentrated group of well-off individuals composes the bulk of the individual income tax base. Domestic financial institutions are also often relatively undeveloped. Thus, it is commonplace for the wealthy to hold investments through offshore accounts.[9] Without proper support mechanisms for the overstretched tax administrators of these countries, it is difficult to constrain their citizens from evading domestic tax liability on capital income and closely held business income by using offshore accounts and offshore entities.

In April 2009 leaders of the G20 countries[10] declared that "[t]he era of banking secrecy is over," and emphasized the importance of including developing countries in what they said would be "a new cooperative international tax environment."[11] Since that time, a growing number of governments[12] and nongovernmental organizations[13] have called for automatic exchange of tax information to address the taxation of offshore accounts. Financial institutions have expressed interest in providing governments with automatic information on cross-border investors and their investment income, at least when promised relief from withholding tax for such investors. The European Union's Savings Directive resulted in a limited form of automatic information exchange among most EU countries, and proposals of the last few years would expand its scope. FATCA,[14] legislation enacted by the United States in 2010, will eventually require foreign financial institutions to report

9. *See infra* notes 45–46 and accompanying text.
10. The G20 comprises nineteen member countries and the European Union. The members are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Republic of Korea, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom, the United States, and the European Union. *Members*, G20, http://www.g20.org/index.php/en/members (last visited Oct. 30, 2012).
11. G20, DECLARATION ON STRENGTHENING THE FINANCIAL SYSTEM—LONDON SUMMIT (2009) [hereinafter APRIL 2009 LONDON COMMUNIQUÉ], *available at* http://www.g20.utoronto.ca/2009/2009ifi.pdf.
12. One of the strongest statements came from Indian Prime Minister Manhoman Singh, who suggested that the "G-20 countries should take the lead in agreeing to automatic exchange of tax related information with each other . . . in the spirit of our London Summit [declaration] that 'the era of bank secrecy is over.'" *PM Asks G-20 to Send Strong Message to Stop Tax Evasion*, IBN LIVE, http://ibnlive.in.com/news/send-strong-message-on-tax-evasion-pm-to-g20/198996-2.html (last updated Nov. 3, 2011).
13. The Tax Justice Network has been particularly active and effective in encouraging civil society to focus on automatic exchange of tax information. TAX JUST. NETWORK, http://www.taxjustice.net (last visited Oct. 15, 2012).
14. Hiring Incentives to Restore Employment Act of 2010 (HIRE Act), Pub. L. No. 111-147, §§ 501–535, 124 Stat. 71, 97–115; *see infra* note 98.

financial information about accounts held by specified U.S. persons or be subject to a punitive withholding tax. Finally, the recently revised Convention on Mutual Administrative Assistance in Tax Matters (Multilateral Convention) creates a potential legal platform for multilateral automatic information exchange.

In August 2011, however, both Germany and the United Kingdom signed treaties with Switzerland that reject automatic information exchange and substitute anonymous cross-border tax withholding.[15] Austria and Switzerland reached a similar agreement in April 2012.[16] Under these agreements, Swiss financial institutions will impose withholding tax on behalf of a foreign government and the Swiss government will remit that tax anonymously to the investors' countries of residence without revealing the names of or other information regarding the account holders whose investment earnings give rise to these payments. The Swiss agreements are important because more than 25 percent of the world's offshore wealth is managed from Switzerland, while approximately another 25 percent of the world's offshore wealth is managed from the United Kingdom and its dependencies.[17] Switzerland often acts as a leader for offshore asset management centers, while Germany and the United Kingdom are among the few economic and financial centers with sufficient leverage to exert pressure on governments that are home to important offshore asset managers. The Swiss agreements, particularly if ratified, represent a major blow to multilateral automatic information reporting. Bilateral anonymous

15. *See generally* Agreement Between the Swiss Confederation and the United Kingdom of Great Britain and Northern Ireland on Cooperation in the Area of Taxation, U.K.–Switz., Oct. 6, 2011 [hereinafter U.K.–Switz. Cooperation Agreement], *available at* http://www.hmrc.gov.uk/taxtreaties/swiss.pdf; U.K.–Switz. Protocol Amendment, *supra* note 5; Mutual Agreement Implementing Article XVIII of the Protocol Signed on 20 March 2012, Amending the Agreement Between the Swiss Confederation and the United Kingdom of Great Britain and Northern Ireland on Cooperation in the Area of Taxation, U.K.–Switz., Apr. 18, 2012 [hereinafter U.K.–Switz. Protocol Letters], *available at* http://www.hmrc.gov.uk/taxtreaties/swiss-uk-letters.pdf (increasing the minimum rate payable from 19 percent to 21 percent and increasing the rate payable on £7 million or more to 41 percent). *See also* Abkommen zwischen der Bundesrepublik Deutschland und der Schweizerischen Eidgenossenschaft über Zusammenarbeit in den Bereichen Steuern und Finanzmarkt [Agreement Between the Federal Republic of Germany and the Swiss Confederation on Cooperation in the Area of Taxation and Financial Markets], Ger.–Switz., Sept. 21, 2011 (Ger.) [hereinafter Ger.–Switz. Cooperation Agreement], *available at* http://www.news.admin.ch/NSBSubscriber/message/attachments/24360.pdf; Ger.–Switz. Protocol Amendment, *supra* note 5; Austria–Switz. Cooperation Agreement, *supra* note 5. Additionally, it was announced on June 12, 2012, that Italy and Switzerland are working to revise their double taxation agreement. *See* SWISS FED. DEP'T OF FIN., SWITZERLAND–ITALY TAX DOSSIER (2012), *available at* http://www.news.admin.ch/NSBSubscriber/message/attachments/27146.pdf.
16. *See* Austria–Switz. Cooperation Agreement, *supra* note 5.
17. BOS. CONSULTING GRP., *supra* note 1, at 13.

withholding agreements are incompatible with a broadly multilateral automatic information exchange system.

Together, the moves by governments and financial institutions toward automatic information exchange and anonymous cross-border withholding represent an important shift for the international tax system. Yet academic discourse has hardly addressed the emerging approaches for cross-border tax intermediation.[18] Practitioners and the press generally focus on a single emerging approach or occasionally note that automatic information exchange and anonymous withholding are in conflict with one another. The commonality between these systems is, however, as important as their differences: The emergence of the EU, Organisation for Economic Cooperation and Development (OECD), Swiss, and U.S. approaches to cross-border tax administrative assistance has shifted the discourse of international tax cooperation from a dispute about whether financial institutions should function as cross-border tax intermediaries to a dispute about how financial institutions should perform that role.

This Article makes three key contributions. First, it highlights the commonality between automatic information exchange and anonymous withholding, and it argues that we are witnessing the birth of a new international regime in which fi-

18. The only article of which I am aware that addresses the differences between all the emerging information reporting models in any detail is Stafford Smiley, *Qualified Intermediaries, the EU Savings Directives, Trace—What Does FATCA Really Add?*, CORP. TAX'N, Sept.–Oct. 2011, at 20. Although I disagree with certain of his conclusions, and he does not consider the clash with anonymous withholding, Smiley makes an important contribution to the literature. In a recent article, Susan Morse compares FATCA's approach to routing information reporting with the approach to routing information taken by the European Union's Savings Directive. She recommends simplifying FATCA diligence and reporting, making side payments to participating countries, and seeking intergovernmental cooperation by offering reciprocity. Susan C. Morse, *Ask for Help, Uncle Sam: The Future of Global Tax Reporting*, 57 VILL. L. REV. (forthcoming 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1999101. Richard Harvey wrote an article focused on FATCA's implementation, but it does not discuss the international context or other emerging approaches. J. Richard Harvey, Jr., *Offshore Accounts: Insider's Summary of FATCA and Its Potential Future*, 57 VILL. L. REV. (forthcoming 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1969123. In late 2009 Jefferson VanderWolk wrote an insightful and prescient article suggesting that the change in international norms with respect to information exchange upon request was likely to be an initial stage in a process that would eventually result in broader and more automatic exchanges of information between tax authorities. *See generally* Jefferson P. VanderWolk, *The New World of Tax Information Exchange*, 13 ASIA-PAC. J. TAX'N 166 (2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1582452. For an early paper emphasizing that "multilateral coordination has become necessary to achieve the effective international information exchanges required for residence-based taxation of [foreign portfolio] income," and that "the threat of coordinated multilateral defensive measures may coerce tax havens into entering into information exchange agreements with OECD [Organisation for Economic Cooperation and Development] countries," see Michael J. Graetz & Itai Grinberg, *Taxing International Portfolio Income*, 56 TAX L. REV. 537, 579–80 (2003).

nancial institutions act as cross-border tax intermediaries with respect to offshore accounts.[19] Second, it explains why automatic information reporting solutions are preferable to anonymous withholding solutions.[20] Finally, this Article begins to address how to reconcile the emerging and incongruent proposals for automatic information reporting in a manner that will promote the emergence of a multilateral automatic information reporting system.

Part I of this Article introduces the events that catalyzed the present evolutionary moment in cross-border tax cooperation and describes why the push for greater transparency to address offshore tax evasion may be even more important to emerging and developing economies than it is to developed economies. Part II describes the nascent approaches to cross-border tax cooperation being developed by the European Union, the OECD, Switzerland, and the United States. It argues that all of these approaches build on the premise that financial institutions should be cross-border tax intermediaries. The fact that both government and private sector expectations are converging around this premise marks the emergence of a new regime.

Part III argues that the automatic information reporting model is superior to the anonymous withholding model. Automatic information reporting solutions can address concerns regarding the accretion of untaxed principal, whereas anonymous withholding solutions cannot. Automatic information reporting also undergirds voluntary compliance by preserving tax morale, maintains expressive values associated with the taxation of capital income, and supports government policy flexibility, particularly outside the large developed economies.[21] Finally, unlike anonymous withholding, an automatic information reporting solution has the capacity to develop into a broadly multilateral regime.

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19. I employ Stephen Krasner's classic definition of "international regime": "implicit or explicit principles, norms, rules and decision-making procedures around which actors' expectations converge in a given area of international relations." Stephen D. Krasner, *Structural Causes and Regime Consequences: Regimes as Intervening Variables*, 36 INT'L ORG. 185, 186 (1982).

20. From a tax administrator's perspective, this comparison is between two second-best alternatives. The ideal compliance system would provide for both nonanonymous withholding and information reporting. This Article does not address that possibility because it is not presently under consideration internationally.

21. Some might query the degree to which the tax and development literature supports progressive personal income taxation and challenge the recommendations of this Article on those grounds. *See generally* Richard M. Bird & Eric M. Zolt, *Redistribution via Taxation: The Limited Role of the Personal Income Tax in Developing Countries*, 52 UCLA L. REV. 1627 (2005). If administration were less of a concern because of improved global cooperation, however, then scholars with concerns regarding administrability might be more likely to endorse schedular income taxation of capital income by developing countries, at least at the top of the income distribution, as one part of a broader strategy to address inequality. *See id.* at 1659–60, 1689–92.

The development of the new regime is likely to be path dependent, however, and bilateral anonymous withholding along with limited use of automatic information exchange may be the most likely default. A critical mass of anonymous withholding agreements would likely produce a suboptimal equilibrium that would allow only a limited group of countries to reap benefits from financial institutions functioning as cross-border tax intermediaries. Thus, the emergence of a multilateral automatic information reporting system requires progress in the near to medium term before an anonymous withholding system becomes ensconced.

At present it remains unclear whether the world is on the path toward automatic information exchange, anonymous withholding, or some combination thereof. Part IV provides proposals as to how the emerging information reporting models could be harmonized to encourage the development of a multilateral automatic information exchange system. It also proposes safeguards to address concerns that information exchanged automatically might be misused in some countries.[22]

I. THE BEGINNING OF EVOLUTIONARY CHANGE IN CROSS-BORDER TAX ADMINISTRATIVE ASSISTANCE

A. Information Exchange Upon Request and Its Inadequacy

Most governments of major developed countries agree that access to information from other countries is vital to the full and fair enforcement of their tax laws.[23] Consequently, bilateral tax treaties generally provide for information ex-

22. By studying a particular problem in international tax diplomacy and regime conflict, this Article is also responsive to Diane Ring's observation that the international tax literature lacks such scholarship and could greatly benefit from it. Diane Ring, *International Tax Relations: Theory and Implications*, 60 TAX L. REV. 83 (2007).

23. For example, over the years the International Tax Counsel of the United States have consistently testified before the Senate Foreign Relations Committee that access to information from other countries is critically important to U.S. tax law enforcement. *See, e.g.*, *Tax Convention With the United Kingdom (T.Doc. 107-19) and Protocols Amending Tax Conventions With Australia (T. Doc. 107-20) and Mexico (T. Doc. 108-3): Hearing Before the S. Comm. on Foreign Relations*, 108th Cong. 9 (2003) (statement of Barbara M. Angus, Int'l Tax Counsel, U.S. Dep't of Treasury) ("Because access to information from other countries is critically important to the full and fair enforcement of the U.S. tax laws, information exchange is a priority for the United States in its tax treaty program. If a country has bank secrecy rules that would prevent or seriously inhibit the appropriate exchange of information under a tax treaty, we will not conclude a treaty with that country. [I]t is one of a very few matters that we consider non-negotiable."); *Treaty Doc. 112-01: Protocol Amending Tax Convention With Swiss Confederation*; *Treaty Doc. 111-08: Protocol Amending Tax Convention With Luxembourg; Treaty Doc. 111-07: Tax Convention With Hungary*; *Treaty Doc. 110-23: Investment Treaty With Rwanda; Treaty Doc. 111-06: Mutual Legal Assistance Treaty With Bermuda: Hearing Before the S. Comm. on Foreign*

change between tax authorities. Such provisions have appeared in tax treaties since at least World War II.[24] However, the OECD Model Tax Convention (OECD Model Treaty), the world's dominant model tax treaty, requires information exchange only upon request, while permitting but not requiring automatic information exchange.[25] The OECD's standards do not permit "fishing expeditions" in a request for information from one country to another. Until very recently, that limitation was understood to allow only requests about specific taxpayers, identified by name, in circumstances in which the requesting government could explain why it had reason to suspect it needed information about that taxpayer's affairs.[26]

Prior to 2009, the major developed economies and the OECD were hamstrung in their efforts to achieve comprehensive information exchange upon re-

Relations, 111th Cong. (2011) (statement of Manal Corwin, Int'l Tax Counsel, U.S. Dep't of Treasury).

24. *See* Steven Dean, *The Incomplete Global Market for Tax Information*, 49 B.C. L. REV. 605, 648–53 (2008) (describing bilateral tax information exchange upon request as a barter system that allows pairs of governments to barter with one another for information that each can use to enforce their own taxes and exploring the possibility of a market for cross-border tax information in which governments could buy and sell taxpayer information for consideration other than reciprocity).

25. OECD, ARTICLES OF THE MODEL CONVENTION WITH RESPECT TO TAXES ON INCOME AND ON CAPITAL art. 26 (2008) [hereinafter OECD MODEL CONVENTION]. Both the OECD's Model Convention and Model Tax Information Exchange Agreement (for countries wishing to agree to tax information exchange without a broader tax treaty) require information exchange *upon request*. International standards in this area were developed by the OECD and eventually endorsed by the G8, the G20, and the United Nations (U.N.), leading the OECD to describe the results as representing international standards for transparency and exchange of tax information. These standards require (1) information exchange upon request where it is "foreseeably relevant" to the administration and enforcement of the treaty partner's domestic laws, (2) no restrictions on exchange caused by bank secrecy or domestic tax interest requirements, (3) availability of reliable information and power to obtain that information, (4) respect for taxpayers' rights, and (5) ensuring that information that is exchanged remains strictly confidential. OECD, OVERVIEW OF THE OECD'S WORK ON COUNTERING INTERNATIONAL TAX EVASION (2009) [hereinafter OECD, COUNTERING INTERNATIONAL TAX EVASION].

26. *See* OECD MODEL CONVENTION, *supra* note 25, art. 26. *Compare* OECD, AGREEMENT ON EXCHANGE OF INFORMATION ON TAX MATTERS art. 5 [hereinafter OECD TIEA], *available at* http://www.oecd.org/ctp/harmfultaxpractices/2082215.pdf, *with* OECD, UPDATE TO ARTICLE 26 OF THE OECD MODEL TAX CONVENTION AND ITS COMMENTARY ¶ 5.2 [hereinafter OECD, 2012 UPDATE], *available at* http://www.oecd.org/ctp/exchangeofinformation/latest documents/120718_Article 26-ENG_no cover (2).pdf. Under the revised commentary to Article 26 of the OECD Model Convention released on July 17, 2012, a request for information relating to a group of unidentified taxpayers will be viewed as a "fishing expedition"—that is, speculative and lacking nexus—unless the requesting state can provide the following to the requested state: (1) a detailed description of the group, (2) the specific facts and circumstances underlying the request, (3) an explanation of the applicable law, and (4) "why there is reason to believe that the taxpayers in the group for whom information is requested have been non-compliant with that law supported by a clear factual basis." Furthermore, the requesting state must show that the requested information "would assist" in determining whether the taxpayers in the group complied with the tax law.

quest. The chief obstacle was that four OECD member states—Austria, Belgium, Luxembourg, and Switzerland—were committed to bank secrecy as a bar to tax information exchange upon request.[27] One of the countries, Switzerland, is the location of more than 25 percent of the global offshore wealth management industry as measured by assets under management,[28] and the others also have important histories as offshore banking centers. Significant non-OECD financial centers (such as Hong Kong, Liechtenstein, Panama, and Singapore) felt comfortable following the lead of Switzerland and the other OECD bank secrecy jurisdictions in rejecting exchange upon request of bank information.

In 2008, however, the issue of offshore tax evasion moved high on the global political agenda, largely as a result of two notable scandals. The first of these scandals resulted in prosecutions for tax evasion through accounts held at LGT bank in Lichtenstein, primarily against residents of Germany and other large European countries.[29] The second scandal led the United States to act against UBS for conspiring to defraud it by helping U.S. customers conceal their ownership of, or beneficial interest in, income and assets held through offshore accounts in Switzerland and other jurisdictions.[30] Responding to a widespread understanding that LGT and UBS were merely exemplars of a much broader problem, world leaders at the April 2009 G20 London Summit stated that they "stand ready to take agreed action against those jurisdictions which do not meet international standards in relation to tax transparency."[31] The G20 called attention to a document the OECD published on the same day as the London Summit that listed countries that had not committed to or substantially implemented international

27. Historically, the OECD had pressured nonmembers to conform to high standards regarding tax information exchange but, given its consensus-based system for agreement among member countries, found it difficult to pressure its own four bank secrecy jurisdictions. Statements regarding the importance of information exchange and compliance with international standards could not hide the fact that there was no true consensus among developed governments as to how to manage their own outliers (such as Austria and Switzerland) on this issue. The unwillingness or inability of the major developed economies to confront fellow OECD members sparked understandable calls of hypocrisy from other offshore financial centers during the late 1990s in the course of the OECD's efforts to combat so-called harmful tax competition. Those outcries were effective in limiting pressure on jurisdictions opposed to liberal global tax information exchange rules.
28. *See* BOS. CONSULTING GRP., *supra* note 1, at 13.
29. *See* Lynnley Browning, *Banking Scandal Unfolds Like a Thriller*, N.Y. TIMES, Aug. 15, 2008, at C8; *Investigators Find 'Immense' Evasion: Over 160 Tax Dodgers Confess in Liechtenstein Probe*, SPIEGEL ONLINE INT'L, Feb. 26, 2008, http://www.spiegel.de/international/business/0,1518,537839,00.html; *Liechtenstein Tax Evasion Scandal: Informant in German Investigation 'Fears' for His Life*, *supra* note 2.
30. *DOJ Announces Deferred Prosecution Agreement With UBS*, TAX NOTES TODAY, Feb. 19, 2009, *available at* LEXIS, 2009 TNT 31-32.
31. APRIL 2009 LONDON COMMUNIQUÉ, *supra* note 11, at 4.

standards for tax transparency. For the first time, such an OECD list included the bank secrecy countries that were OECD members.[32]

The April 2009 G20 Summit and OECD list catalyzed the present evolutionary moment in cross-border administrative assistance for tax purposes.[33] Within a few years of being threatened with sanctions by the G20, those jurisdictions previously unwilling to exchange information upon request in accordance with OECD standards changed their position and began to comply with this new global norm. However, information exchange upon request is, on its own, inadequate to combat offshore tax evasion. The ability to request information regardless of bank secrecy does have some chilling effect on tax evasion because evaders cannot rely on bank secrecy to conceal their activities. At the same time, to receive information upon request, a tax administration was traditionally required to name the taxpayer, to know which jurisdiction to ask for information, to know at which financial institution a taxpayer may hold her account, and to have a credible suspicion of tax evasion.[34] Otherwise, the request could be denied as a "fishing expedition." A requirement that a requesting tax administration have such specific and detailed information limits the effectiveness of information exchange upon request as a means to combat offshore tax evasion systematically.[35]

Recent actions by legislatures, tax administrations, and prosecutors of the world's major developed economies demonstrate their belief that information exchange upon request is inadequate to fight offshore tax evasion. Various G7 governments have purchased account data stolen by insiders from banks,[36] shared stolen information among themselves and used it to prosecute tax evaders,[37] re-

32. *Id.* at 4.
33. Following the release of the G20 communiqué, previously recalcitrant jurisdictions made formal commitments to the OECD information exchange upon request standard and shortly thereafter began passing legislation to implement their stated commitments. *See, e.g.*, David Crawford & Jesse Drucker, *Swiss to Relax Bank Secrecy Laws*, WALL ST. J., Mar. 14, 2009, http://online.wsj.com/article/SB123694252262918343.html.
34. OECD TIEA, *supra* note 26, art. 5(5); *see also* OECD MODEL CONVENTION, *supra* note 25, art. 26.
35. *See* John Christensen & David Spencer, *Stop This Timidity in Ending Tax Haven Abuse*, FIN. TIMES, Mar. 5, 2008, at 13, *available at* http://www.ft.com/intl/cms/s/0/63cdb642-ea03-11dc-b3c9-0000779fd2ac.html. *But see* OECD, 2012 UPDATE, *supra* note 26, ¶ 5.2 (changing the Commentary to Article 26 of the OECD Model Convention explicitly to authorize requests relating to a group of unidentified taxpayers in certain circumstances).
36. *See* Carter Dougherty & Mark Landler, *Tax Scandal in Germany Fans Complaints of Inequality*, N.Y. TIMES, Feb. 18, 2008, http://www.nytimes.com/2008/02/18/business/worldbusiness/18tax.html.
37. *See* H. Arnold Sherman, *The War on Offshore Tax Evasion*, STEP J., Sept. 2010, http://www.stepjournal.org/journal_archive/2010/step_journal_september_2010/the_war_on_offshore_tax.aspx (noting that the American, French, and German tax authorities have all used stolen information purchased from employees of foreign banks to prosecute taxpayers evading domestic tax obligations).

quired foreign banks to report on or close their residents' accounts,[38] opened up investigations of and prosecuted financial institutions with large offshore asset management businesses,[39] entered agreements to require anonymous withholding on their residents' offshore accounts,[40] demanded automatic information reporting,[41] and linked enhanced penalties for offshore tax evasion by their citizens to the tax transparency of the territory in which the income or gain arises.[42] These unilateral techniques, while somewhat effective, often are not available to less powerful countries looking to address their own offshore tax evasion concerns.

B. Emerging and Developing Economies Are Most Exposed

The best available data suggests that compliance concerns over tax evasion through offshore accounts are likely to be greater for emerging and developing economies than for developed economies. Meanwhile, lower administrative capacity in emerging and developing economies can reduce the efficacy of information exchange upon request as a tool with which those countries combat offshore tax evasion. They often lack the audit and investigative skills to determine which country to ask about which resident taxpayer.

Offshore wealth represents 6.4 percent of the more than $120 trillion of global wealth.[43] However, the extent to which taxpayers' assets are managed offshore

38. *See* Joint Declaration by the Government of the Principality of Liechtenstein and Her Majesty's Revenue and Customs Concerning the Memorandum of Understanding Relating to Cooperation in Tax Matters, Liech.–U.K., Aug. 11, 2009, *available at* http://www.hmrc.gov.uk/international/joint-declaration-lich.pdf. The United Kingdom entered into a treaty in which Liechtenstein, under pressure, agreed that financial intermediaries in Liechtenstein will identify persons who may be liable to tax in the United Kingdom and either obtain certification that such person is compliant with their U.K. tax obligations or close the account. Somewhat similarly, FATCA requires foreign financial institutions to report on, withhold on, or close U.S. accounts.
39. Randall Jackson, *U.S. Offers 11 Swiss Banks Deals to End Tax Evasion Investigation*, 134 TAX NOTES 71 (2012).
40. U.K.–Switz. Cooperation Agreement, *supra* note 15; Ger.–Switz. Cooperation Agreement, *supra* note 15.
41. *See, e.g.*, Hiring Incentives to Restore Employment Act of 2010 (HIRE Act), Pub. L. No. 111-47, §§ 501–535, 124 Stat. 71, 97–115 ("Foreign Account Tax Compliance"); Council Directive 2011/16/EU, Administrative Cooperation in the Field of Taxation and Repealing Directive 77/799/EEC, 2011 O.J. (L 64) 1 [hereinafter February Directive]; *see also PM Asks G-20 to Send Strong Message to Stop Tax Evasion*, *supra* note 12.
42. *See, e.g.*, Finance Act, 2010, c. 13, § 35, sch. 10 (U.K.).
43. BOS. CONSULTING GRP., *supra* note 1, at 13. BCG estimates that global wealth at the end of 2010 stood at $121.8 trillion. Households outside the major developed economies hold approximately 25 percent of global wealth, with $21.7 trillion in wealth held by households in Asia and the Pacific, excluding Japan, $4.5 trillion in the Middle East and Africa, and $3.5 trillion in Latin America (defined to include Mexico). Global wealth for this purpose includes all assets under management across all

is not uniform across regions of the world. Boston Consulting Group (BCG) has estimated that less than 2 percent of North American wealth and less than 8 percent of European wealth is held offshore.[44] In contrast, more than 25 percent of all Latin American household wealth, representing $900 billion, and almost 33 percent of all Middle Eastern and African wealth, representing $1.4 trillion, is held offshore.[45] Households outside the major developed economies hold approximately 25 percent of global wealth (including $21.7 trillion in wealth for households in Asia and the Pacific, excluding Japan).[46] Wealth is also much more concentrated[47] and growing at a significantly faster rate outside North America, Japan, and Western Europe, with experts expecting that trend to continue.[48] Thus, the taxation of offshore wealth should be of greater relative importance to Latin America, the Middle East, and Africa than to the United States and Canada or to the major European economies. Data on actual revenues lost by developing countries and emerging economies overall from offshore tax evasion are unreliable. However, OECD officials have stated that revenue losses, only a portion of which are attributed to the use of offshore accounts by resident individuals, may be of a magnitude that approximates all official development assistance worldwide (totaling $120 billion per year).[49]

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households worldwide, including worldwide cash deposits, money market funds, and listed securities held directly or indirectly through managed investments, and it includes all onshore and offshore assets. It excludes wealth attributed to individuals' own businesses, residences, or luxury goods. The major developed economies are Canada, Europe, Japan, and the United States. *Id.* at 5, 7 & n.3.

44. In all, $0.7 trillion of $38.2 trillion in North American wealth is held offshore, representing 2 percent of North American wealth. Three trillion dollars in European wealth is held offshore, representing 8 percent of European wealth. *Id.* at 7, 13.
45. *Id.* at 5, 7 & n.3.
46. *Id.* at 7.
47. In Europe, for example, 1.1 percent of households held more than $1 million in assets under management, representing in total 26 percent of European wealth. *Id.* at 8. In contrast, in Latin America, 0.24 percent of households held more than $1 million in assets under management, representing 36 percent of total Latin American wealth, and in the Middle East and Africa, 0.3 percent of households held more than $1 million in assets under management, representing 45 percent of total Middle Eastern and African wealth. *Id.*
48. *See id.* at 10; *see also* MERRILL LYNCH & CAP GEMINI, WORLD WEALTH REPORT 6 (2011).
49. Remarks of Jeffrey Owens, Dir. of the Centre for Tax Policy and Admin. of the OECD, Meeting of the OECD's Informal Task Force on Tax and Development (May 10–11, 2010) (author's notes and discussions with attendees) (suggesting that revenue losses may equal the sum spent on official development assistance worldwide; note that Mr. Owens has since retired from the Centre for Tax Policy and Administration); *see also* OECD DEV. ASSISTANCE COMM., REFLECTION EXERCISE: INVESTING IN DEVELOPMENT: A COMMON CAUSE IN A CHANGING WORLD 3 (2009), *available at* http://www.oecd.org/dataoecd/14/1/43854787.pdf (noting that official development assistance totaled $120 billion in 2008). Commentators estimate that offshore tax evasion in the developing world is much more extensive. *See, e.g.*, DEV KAR & DEVON CARTWRIGHT-SMITH, GLOBAL FIN. INTEGRITY, ILLICIT FINANCIAL FLOWS FROM DEVELOPING COUNTRIES 2002–

Emerging economies' concerns with offshore tax evasion are not limited to revenue loss. As in the developed world, an inability to collect tax on income and wealth held through offshore accounts and entities may undermine tax morale and threaten the broader administration of the domestic tax system. Moreover, in administrative regimes characterized by limited competence, widespread awareness of evasion through offshore accounts by the wealthy or privileged may undermine the authority and effectiveness of the state. The Indian Supreme Court, which handled a series of cases associated with corruption and tax evasion in recent years, described the problem thus:

> Unaccounted for monies, especially large sums held by nationals and entities with a legal presence in the nation, in banks abroad . . . would also indicate a substantial weakness in the capacity of the State in collection of taxes on incomes generated by individuals and other legal entities within the country. The generation of such revenues is essential for the State to undertake the various public goods and services that it is constitutionally mandated, and normatively expected by its citizenry, to provide. A substantial degree of incapacity, in the above respect, would be an indicia of the degree of failure of the State; and beyond a particular point, the State may spin into a vicious cycle of declining moral authority, thereby causing the incidence of unlawful activities in which wealth is sought to be generated, as well as instances of tax evasion, to increase in volume and in intensity.[50]

II. BEYOND INFORMATION EXCHANGE UPON REQUEST

At the start of the twenty-first century, outside of information exchange upon request, there were few mechanisms in place by which governments or financial institutions automatically provided effective assistance to a foreign sovereign attempting to tax assets held offshore by the foreign sovereign's residents.[51] This sit-

2006 (2009) (estimating illicit financial flows out of developing countries at $850 billion to $1 trillion each year). Clemens Fuest and Nadine Riedel are skeptical of the higher figures, however, and further conclude that "most existing estimates of tax revenue losses in developing countries due to evasion and avoidance are not based on reliable methods and data." CLEMENS FUEST & NADINE RIEDEL, TAX EVASION, TAX AVOIDANCE AND TAX EXPENDITURES IN DEVELOPING COUNTRIES: A REVIEW OF THE LITERATURE, at vi (2009) (emphasis omitted).

50. Ram Jethmalani v. Union of India, (2011) 8 S.C.C. 1, 14 (India).

51. For example, Australia, now an international leader in unilaterally and automatically supplying other jurisdictions with usable resident taxpayer information, engaged in its first automatic exchange of information in 2000. *See* AUSTL. NAT'L AUDIT OFFICE, AUDIT REPORT NO. 34 2009–10, THE MANAGEMENT AND USE OF DOUBLE TAXATION AGREEMENT INFORMATION COLLECTED THROUGH AUTOMATIC EXCHANGE 37 (2010), *available at* http://www.anao.gov.au/uploads/

uation persisted despite the fact that financial institutions had served as tax intermediaries domestically in almost all major developed economies for decades and despite large, wealthy economies' longstanding concerns about evasion of domestic taxes through offshore accounts.[52] Even within the European Union, a sui generis pooling of sovereignty with significant interstate cooperation, debates about routine cooperation on the taxation of a single category of income—interest—did not progress for decades.[53] Germany, the European Union's most powerful government, was forced to change its regime for taxing capital income when its citizens found it too easy and tempting to evade German taxes by holding assets through a foreign account in another EU jurisdiction.[54]

Some discussions in the late 1990s suggested small steps toward improving the availability of bank information for cross-border tax purposes,[55] but progress in

documents/2009-10_Audit_Report%20_34.pdf. One noteworthy exception was U.S. reporting to Canada regarding bank deposit interest and reciprocal Canadian reporting to the United States with respect to financial payments made to any person disclosing a permanent U.S. address. Treas. Reg. § 1.6049-8 (as amended in 1997). There were also certain other routine information exchanges relating to certain passive income flows, often providing bulk data that was not attributable to any given taxpayer or was otherwise unusable.

52. At least as early as 1970, the U.S. Congress was concerned about the issue, as it noted in a congressional report accompanying the passage of the Bank Secrecy Act of 1970, Pub. L. No. 91-508, 84 Stat. 1114, which stated: "[T]hese days when the citizens of this country are crying out for tax reform and relief, it is grossly unfair to leave the secret foreign bank account open as a convenient avenue of tax evasion." H.R. REP. NO. 91-975, at 4 (1970), *reprinted in* 1970 U.S.C.C.A.N. 4394, 4397; *see also* Thomas Rixen & Peter Schwarz, *How Effective Is the European Union's Savings Tax Directive? Evidence From Four EU Member States*, 50 J. COMMON MARKET STUD. 151, 152 (2012) (arguing that agreement on the EU Savings Directive in 2003 was the product of thirty-five years of negotiations). Indeed, French concerns with tax evasion through Swiss banks predate World War II. *See* Débats Parlementaires, No. 87, Chambre des Députés, Séance du 10 novembre 1932, 1932 J.O. 2997. Note that the OECD developed the first paper-based protocol for automatic information exchange in 1981. OECD, *Recommendation of the Council Concerning a Standardised Form for Automatic Exchanges of Information Under International Tax Agreements*, OECD Doc. C(81)39/FINAL (May 5, 1981).

53. *See, e.g.*, Charles-Henry Courtois, *The Impact of the European Commission on the Council of Ministers' Decisions in the Field of European Taxation: The Case of the European Savings Directive*, 2 INT'L PUB. POL'Y REV. 26, 30 (2006); Alex Easson, *The Tax Competition Controversy*, 18 TAX NOTES INT'L 371, 371 (1999) (describing how a 1989 EU Commission predecessor proposal to the Savings Directive was "quickly dropped").

54. Germany saw a major outflow of domestic capital to Luxembourg and other European states after imposing a withholding tax on domestic interest income and was forced to repeal that tax to staunch the losses. *See* Courtois, *supra* note 53; *see also* Claudio M. Radaelli, *Harmful Tax Competition in the EU: Policy Narratives and Advocacy Coalitions*, 37 J. COMMON MARKET STUD. 661 (1999).

55. *See* OECD, IMPROVING ACCESS TO BANK INFORMATION FOR TAX PURPOSES (2000), *available at* http://www.oecd.org/dataoecd/3/7/2497487.pdf; OECD, HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE (1998), *available at* http://www.oecd.org/dataoecd/33/0/1904176.pdf.

this direction was limited.[56] In the early years of the twenty-first century, hopes of grander collective steps proved largely illusory. The most important nascent example of automatic cooperation with respect to bank information was the European Union's Savings Directive (EUSD). That directive became effective in 2005 and requires financial institutions in a specific subset of jurisdictions to report information on certain interest income (and only interest income) paid to EU residents who reside in a jurisdiction other than the jurisdiction where the financial institution is located.[57] Scholars believed that it could be a forerunner of broader international cooperation, but that hope had yet to be realized.[58]

In the last few years, the global landscape has changed radically. Interest in systematic, automatic information exchange grew in parallel to the mounting universal acceptance of information exchange upon request as a global norm. The OECD's work on standard transmission formats created a progressively more effective technical platform for automatic information exchange that governments are increasingly using in ad hoc bilateral exchanges, and an update of the Convention on Mutual Administrative Assistance in Tax Matters (Multilateral Convention) created a viable legal framework for multilateral information exchange.[59] Meanwhile, since 2007, three concrete models for automatic information exchange have emerged: the OECD's authorized-intermediary project,

56. *See, e.g.*, Angel Gurría, Secretary-Gen., OECD, Address at the Parliamentary Assembly Session of the Council of Europe (Oct. 6, 2010), *available at* http://hub.coe.int/parliamentary-assembly-sessions/all-session-news-october-2010/statement-by-angel-gurria ("[W]e have achieved important breakthroughs in combating tax evasion. This includes the exchange of information for tax purposes, where we have made more progress in the past two years than in the previous ten.").

57. A European Union directive is a non-self-executing legislative act of the Institutions of the European Union that European Union member states must implement, whether by national legislation or by regulatory action. Treaty of Lisbon Amending the Treaty on European Union and the Treaty Establishing the European Community, Dec. 17, 2007, art. 249, 2007 O.J. (C 306).

58. *See* Graetz & Grinberg, *supra* note 18, at 585.

59. *See, e.g.*, OECD, *Recommendation of the Council on the Use of Tax Identification Numbers in an International Context*, OECD Doc. C(97)29/FINAL (Mar. 13, 1997) [hereinafter OECD, *Recommendation on Tax Identification Numbers*]; OECD, *Recommendation of the Council on the Use of the Revised OECD Standard Magnetic Format for Automatic Exchange of Information*, OECD Doc. C(97)30/FINAL (Mar. 13, 1997); OECD, *Recommendation of the Council on the Use of the OECD Model Memorandum of Understanding on Automatic Exchange of Information for Tax Purposes*, OECD Doc. C(2001)28/FINAL (Mar. 22, 2001); *Tool Kit on Automatic Exchange of Information*, OECD, http://www.oecd.org/document/18/0,3746,en_2649_33767_40499474_1_1_1_1,00.html (last visited Oct. 31, 2012). A number of bilateral electronic automatic information exchange relationships were established beginning in the early 2000s, but the types of data exchanged were highly variable and the ability to match the data to taxpayer records was initially quite poor. The last few years have seen an increase in both the number of automatic information exchange relationships and the quality of taxpayer matching for automatically exchanged information. *See, e.g.*, AUSTL. NAT'L AUDIT OFFICE, *supra* note 51, at 93–95.

the European Union's Directive on Administrative Cooperation in the Field of Taxation and its proposed revision of the EUSD, and the United States's FATCA legislation. These models demonstrate how information on investment income earned through offshore accounts[60] could flow automatically from financial institutions to residence country governments, thereby facilitating enforcement of residence country tax burdens on income earned through offshore accounts.

The only academic commentator who compares all three emerging models for systematic, automatic information exchange describes the models as competing with one another.[61] A fourth model, the Swiss anonymous withholding model, presents an even sharper contrast. Instead of offering an information reporting solution, this approach emphasizes anonymity in combination with a withholding regime for collecting revenue from nonresident account holders.[62]

However, focusing on the inconsistencies and conflicts between the emerging systems obscures their commonality, which is more important than their differences. All four models share a key feature that the literature has yet to recognize: Each requires domestic financial institutions to routinely provide cross-border administrative assistance to sovereigns outside the country in which the financial institution is located and thereby to serve as cross-border tax intermediaries. This alone is a critically important achievement. For years, financial institutions have acted as domestic tax intermediaries by providing information reporting on their domestic payees to the tax administration of the payees' respective countries of residence, by withholding from such payees and remitting the withheld amounts to the domestic tax administration, or both. But even five years ago, no one would have claimed that financial institutions were obligated to act as cross-border tax intermediaries or that there was an emerging consensus that they do so. Countries are now agreeing to a higher level of international tax cooperation and demanding that multinational financial institutions play an additional role in tax collection. In some sense this may be a reclamation of sovereign authority over cross-border asset management; in another sense it acknowledges that multinational financial institutions must play a more extensive role in tax collection in a globalized economy.

60. I use the term "offshore account" to refer to any account through which investments are intermediated on behalf of an individual who is not a tax resident of the jurisdiction in which the institution that provides the financial intermediation services (or the relevant subsidiary or branch of such institution) resides.

61. *See* Smiley, *supra* note 18.

62. *See infra* notes 115–127 and accompanying text.

A. Background: Source-Country Taxation and Financial Intermediation

This Part introduces nomenclature used throughout the Article and describes the United States's qualified intermediary system (QI). It begins with a simplified example of how modern financial intermediation of cross-border portfolio investment works. The example is intended to help readers understand the details of the various emerging information exchange approaches discussed in Part II.B and thereafter. This Part then addresses QI, which began operating in 2001 and was primarily intended to ensure that the United States properly taxed non-U.S. persons making portfolio investments in the United States on income from those investments. QI was therefore directed at taxation of U.S.-source income received by foreigners ("source-country taxation") rather than at the problem of taxing U.S. citizens and residents on investments made through foreign financial institutions (a part of "residence country taxation"). In this sense, QI is not a precursor to the emerging approaches to cross-border administrative assistance, each of which addresses residence country concerns with respect to cross-border tax evasion. Still, QI is relevant historically because (1) it marked the first time financial institutions routinely acted as cross-border tax intermediaries, (2) it provided one of the conceptual seeds for the anonymous withholding approach currently being promoted by Switzerland as a means to address residence country tax concerns, and (3) the OECD's authorized-intermediary project, discussed in Part II.B, started with a QI model, although it ultimately developed an approach that is more responsive to residence country tax enforcement concerns.

1. Cross-Border Portfolio Investment and Source-Country Taxation

Host-country tax on nonresidents who make portfolio investments in securities[63] issued by an entity in that country (the "source country") is usually assessed by means of a tax that a domestic payor is required to withhold from gross payments made to foreign investors ("withholding taxes"). Like most countries, the United States imposes a withholding tax on portfolio dividends (30 percent under U.S. law[64]) and then reduces that tax rate under bilateral treaties, but only when a qualifying resident of the treaty country beneficially owns the dividend.[65] As a result,

63. These portfolio investments include small investments in debt and equity securities by noninstitutional investors.
64. I.R.C. § 871 (2006 & Supp. V 2011).
65. *See* U.S. MODEL INCOME TAX CONVENTION OF NOVEMBER 15, 2006, art. 10, at 16–17 (2006) [hereinafter U.S. MODEL INCOME TAX CONVENTION], *available at* http://www.treasury.gov/press-center/press-releases/Documents/hp16801.pdf.

different rates of withholding tax apply to different foreign investors depending on where they reside and whether they are eligible for the benefits of a treaty.

This administrative challenge is exacerbated by the highly intermediated nature of modern cross-border portfolio investment. A simplified example both illustrates the problem and introduces key terminology. A typical investment made by an Indian national in a U.S. company can involve the Indian national providing funds to Singapore Bank A, which in turn provides those funds to Singapore Bank B, which in turn provides the funds to U.S. Bank C, which then makes the investment in the U.S. company by holding shares through a central securities depository, a type of clearinghouse for securities transactions (U.S. Clearinghouse). Income from those investments will generally flow from the U.S. company to its paying agent, then on to the U.S. Clearinghouse, then to U.S. Bank C, on to Singapore Bank B, and from Singapore Bank B to Singapore Bank A, which will credit the relevant funds to the Indian national's account. In this example, India is the investor's country of residence (residence country), the United States is the country that is the source of the income (source country), and Singapore is the country from which the assets are being managed (asset management country).[66]

Absent some mechanism to provide more detailed information, only Singapore Bank A knows on which client's behalf the given investment was made. At every other stage in the process, the investment is generally made through so-called omnibus accounts that identify the financial institution from which the investment is received rather than the investor on whose behalf the investment is made. No private or public institution in either the residence country or the source country need know the identity of the client who is the beneficial owner of the investment.

In this example, determining the tax rate that the United States should impose on the income resulting from the investment is an aspect of source-country taxation. The questions are whether the ultimate investor, the Indian national, is eligible for a reduction in withholding pursuant to a treaty between the United States and India, and how that information is taken into account by the U.S. payor that is responsible for imposing the proper withholding tax on a dividend payment it makes to Singapore Bank B. It is important to note that the residence country taxation question—how India, the residence country, will effectively administer its

66. To generalize more broadly, "[i]ncome payments arising from securities typically will flow from the issuer to its paying agent and from the paying agent through [multiple] intermediaries to the end investors." OECD, REPORT OF THE INFORMAL CONSULTATIVE GROUP ON THE TAXATION OF COLLECTIVE INVESTMENT VEHICLES AND PROCEDURES FOR TAX RELIEF FOR CROSS-BORDER INVESTORS ON POSSIBLE IMPROVEMENTS TO PROCEDURES FOR TAX RELIEF FOR CROSS-BORDER INVESTORS 8 (2009) [hereinafter OECD, ICG REPORT], *available at* http://www.oecd.org/dataoecd/34/19/41974569.pdf.

tax on the earnings from this investment by an Indian national, which will be earned through an account at Singapore Bank A—is entirely separate from the question of how the source country administers its withholding tax.

2. The Qualified Intermediary System

In the 1990s, the United States began to grapple with taxing growing flows of cross-border portfolio investments, including small investments in U.S. debt and equity securities by large numbers of noninstitutional investors.[67] QI represented a bargain between the United States and non-U.S. financial institutions through which the United States addressed this challenge and ensured that the tax it imposes on nonresident portfolio investors is properly enforced.[68] Under QI, non-U.S. financial institutions agree to collect information from their customers investing in the United States as to whether those customers are U.S. persons or non-U.S. persons and as to which of the non-U.S. persons are entitled to reduced rates of withholding tax.[69] Before QI, there was no practical regime in place by which the Internal Revenue Service (IRS) or U.S. withholding agents could make these determinations.[70] The United States provided non-U.S. financial institutions three inducements to cooperate with the new regime: (1) nonresident client anonymity from U.S. financial institutions (thus protecting their clients' identities from their competitors), (2) anonymity from the IRS (thus ensuring that the IRS would not provide information to the tax administration of the investor's country of residence), and (3) accurate and timely treaty benefits for non-U.S. persons.

The QI rules were of particular importance to private banks engaged in asset management because a QI was able to conceal the identity of its non-U.S. customers from both competitor institutions and the IRS. As a result, a QI could ensure that other financial institutions in the chain of intermediation would not be able to steal its customers and could assure its customers that the IRS would not provide

67. *See, e.g.*, William L. Burke, *Tax Information Reporting and Compliance in the Cross-Border Context*, 27 VA. TAX REV. 399, 403–04 & n.11, 407–08 & n.22 (2007).

68. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-99, TAX COMPLIANCE: QUALIFIED INTERMEDIARY PROGRAM PROVIDES SOME ASSURANCE THAT TAXES ON FOREIGN INVESTORS ARE WITHHELD AND REPORTED, BUT CAN BE IMPROVED 12 (2008) [hereinafter GAO, QUALIFIED INTERMEDIARY PROGRAM].

69. These reduced rates may be available under a tax treaty or a U.S. statutory rule. For a thorough discussion of the QI rules as originally promulgated, see generally Carol Doran Klein & Diane L. Renfroe, *The Final Withholding Regulations: A Rube Goldberg Contraption—Will It Work?*, 27 TAX MGMT. INT'L J. 67 (1998).

70. *See* Stephen E. Shay et al., *"What's Source Got to Do With It?" Source Rules and U.S. International Taxation*, 56 TAX L. REV. 81, 122 (2002).

information to their home country's tax authority. After imposition of the QI rules, these benefits existed generally for QI institutions but not for non-QI institutions. In the example, if Singapore Bank A is a QI, it determines the rate of U.S. withholding that should apply to the Indian national and informs Singapore Bank B as to the rate of withholding that should be applied to a pool of investments it is making on behalf of its customers through Singapore Bank B (including the Indian national's investment). It does not, however, provide Singapore Bank B with the Indian national's identity. Singapore Bank B then forwards the pooled information on to U.S. Bank C, which uses that information to impose withholding tax. On the other hand, if Singapore Bank A did not agree to become a QI, new U.S. rules imposed at the same time as the QI system required the bank to collect information from its non-U.S. customers who sought reduced withholding and to send that information up the chain of financial institutions and potentially all the way to the IRS. As one group of prominent practitioners wrote in the late 1990s, "because of the relative secrecy benefits provided to non-U.S. citizens or residents, the failure of a private bank to qualify as a QI would put that bank in a competitive disadvantage in the marketplace."[71]

QI effectively became the first major operational example of a cross-border anonymous withholding regime. Ten years after QI came into operation, however, the UBS scandal demonstrated the extent to which QI could be abused to facilitate U.S. residence country tax evasion by U.S. persons,[72] even as it provided the IRS some assurance that source-country taxation of nonresidents was being collected.[73] The compromises made to launch the QI program and the consequent

71. Thomas A. O'Donnell, Philip Marcovici & Marnin J. Michaels, *The New U.S. Withholding Tax Régime: To Be or Not to Be, a "Qualified Intermediary,"* 27 TAX PLANNING INT'L REV. 3, 4 (2000).

72. The U.S. Justice Department has shown that United Bank of Switzerland (UBS) used QI status to suggest to U.S. clients that it was a more secure institution through which U.S. citizens could evade U.S. tax. *See* Deferred Prosecution Agreement, United States v. UBS AG, No. 09-60033 (S.D. Fla. Feb. 18, 2009). UBS then helped U.S. residents set up entity structures to avoid the reporting and withholding nominally required by QI with respect to U.S. persons' investments back into the United States, thereby allowing them to achieve the anonymity with respect to U.S. investments that was supposed to be provided only to nonresident investors. *See id.* at 2–4 ("Acceptance of Responsibility for Violation of Law"). Hearings and investigations in Congress highlighted the inadequacy of the QI system as a backstop for U.S. residence country taxation. *See generally Tax Haven Banks and U.S. Tax Compliance: Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Homeland Sec. & Gov't Affairs*, 110th Cong. (2008). Sadly, the design features that produced these inadequacies were widely commented on and accepted by U.S. government officials as part of the bargain made with foreign financial intermediaries to improve U.S. source-country nonresident taxation. *See, e.g.*, Shay et al., *supra* note 70, at 125–26.

73. GAO, QUALIFIED INTERMEDIARY PROGRAM, *supra* note 68, at 6–11.

UBS scandal together laid the groundwork for the most recent U.S. legislation intended to address offshore tax evasion by U.S. persons.

B. Emerging Approaches to Automatic Residence-Based Tax Information Exchange

Cross-border information reporting models that are substantially focused on residence country taxation are emerging from the European Union, the OECD, and the United States. This Part describes these models and their histories, highlighting that the new regime for financial institutions to serve as cross-border tax intermediaries emerged only in the last few years. Three key features that distinguish these information reporting approaches from one another are (1) what information they require to be reported across borders (reporting), (2) how they route information from financial institutions to residence country governments (routing), and (3) what mechanisms they use to encourage financial institutions and governments to participate (incentives). Understanding the alternative ways that the emerging information reporting models address reporting, routing, and incentives is necessary to understand the comparison of information reporting to anonymous withholding in Part III.

Part IV, which provides some observations about the bases for a multilateral information reporting system, discusses how to reconcile the different reporting, routing, and incentives features in the emerging information exchange approaches. It also considers three further design features: (4) which financial institutions are included in the system (scope), (5) how the systems identify taxpayers and their countries of residence (identification), and (6) how the systems ensure that financial institutions comply with their rules (verification). Together, identification, reporting, verification, scope, routing, and incentives constitute the six key features of any cross-border information reporting regime.

1. The European Union

In 1998 the EU Commission proposed a directive intended to ensure that a minimum effective tax rate was imposed on interest income earned through accounts held by a resident taxpayer in a foreign EU country.[74] After a few years of

74. Having failed miserably in 1989 with a suggestion to impose a single 15 percent withholding tax on interest income across the European Union, in 1998 the EU Commission tried to focus exclusively on tax evasion associated with interest income. *Proposal for a Council Directive on a Common System of Withholding Tax on Interest Income*, COM (89) 60 final (Feb. 10, 1989) (proposing a Council

bitter debate between EU member states supporting bank secrecy and EU member states supporting information exchange and a series of failed compromises, a proposal emerged. Under the proposal, information exchange was treated as the preferred mechanism for reducing EU residents' evasion of tax on interest income, but EU jurisdictions were allowed to impose a withholding tax during a so-called transitional period. The European Union's bank secrecy jurisdictions (Austria, Belgium,[75] and Luxembourg), however, took the firm position that they would only agree to the proposal if both small banking centers like Liechtenstein and the Channel Islands, as well as major non-EU financial centers like Switzerland and the United States, agreed to adopt equivalent measures.[76]

Non-EU financial centers were not amenable to the EU bank secrecy jurisdictions' demand. Switzerland objected to any information exchange or withholding. Meanwhile, the Clinton administration objected to the "implicit assumption that a withholding tax would be an adequate substitute for the exchange of information."[77] Then in 2002 Glenn Hubbard, the chairman of the White House Council of Economic Advisers in the Bush administration, announced definitively that the United States would not agree to EU requests for across-the-board sharing of information on U.S. savings accounts held by EU residents.[78] By that point,

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Directive on a common system of withholding taxes levied on interest at a 15 percent rate within the European Economic Community). The Commission described its 1998 proposal narrowly as a mechanism to address perceived economic distortions arising from nontaxation of cross-border interest payments made to individuals. *Id.*; *see also* Courtois, *supra* note 53, at 31 (interviewing Commission staff on the history of the European Union Savings Directive (EUSD)).

75. In 2010, Belgium began to exchange information rather than impose a withholding tax on interest income subject to the EUSD. *See Taxation and Customs Union: Rules Applicable*, EUR. COMM'N, http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/rules_applicable/index_en.htm (last visited Oct. 15, 2012).

76. In June 2000 Luxembourg Prime Minister and Finance Minister Jean-Claude Juncker epitomized the EU bank secrecy jurisdictions' unflinching opposition to cooperating in the absence of non-EU member cooperation by stating that "there would be blood on the table if certain other delegations do not change their point of view." George Peter Gilligan, *Whither or Wither the European Savings Tax Directive? A Case Study in the Political Economy of Taxation*, 11 J. FIN. CRIME 56, 59 (2003).

77. Albertina M. Fernández & Thomas F. Field, *Canadian Tax Foundation Holds First World Tax Conference*, 20 TAX NOTES INT'L 1056, 1056 (2000) (quoting Phillip West, Int'l Tax Counsel of the U.S., Address at the World Tax Conference in Tampa Bay, Fla.: Taxes Without Borders (Feb. 26–Mar. 1, 2000)). The public record suggests that during this period significant discussions between the United States and the European Union regarding cross-border administrative assistance may have occurred. It is possible that some U.S. officials may have been prepared to contemplate reciprocity if the European Union moved to an information reporting system rather than an anonymous withholding system or a system that accepted either anonymous withholding or automatic information reporting. Whatever policymakers' intentions, no progress was made.

78. Edward Alden et al., *US Endangers Brown Saving Tax Plan*, FIN. TIMES, Sept. 26, 2002, at 1. In August of 2002 the Bush administration withdrew proposed regulations issued in the Clinton administration's final days, Guidance on Reporting of Deposit Interest Paid to Nonresident Aliens, 66

the continuing EUSD debate was mostly about the parameters of an ever-closer European Union.[79] Broader acceptance of financial institutions as cross-border tax intermediaries did not appear to be forthcoming.

In mid-2003 the European Union agreed to forge ahead internally on a version of the EUSD that would apply after 2005 and was intended to meet the relatively narrow goal of ensuring information reporting or withholding on interest payments earned by EU residents holding, in their own names as individuals, accounts earning interest at financial institutions within Europe.[80] If an EU country exchanges information under the EUSD, financial institutions in that country report information to the tax administration of the EU member state where the financial institution is resident and then relevant information is routed from that tax administration to the tax administration of the member state where an account holder is resident.[81]

The EUSD mandates only that member states either exchange information with one another or impose a withholding tax to be deducted from interest income for so long as an indefinite "transitional period" continues.[82] Most EU countries

Fed. Reg. 3925 (proposed Jan. 17, 2001), that would have required U.S. banks to collect and report to the Internal Revenue Service (IRS) information generally of the type needed to join the Savings Directive. *See* 67 Fed. Reg. 50,386 (Aug. 2, 2002) (withdrawing and re-proposing the bank deposit interest regulations). Initially, those regulations were replaced with proposed regulations that would have required the collection of bank deposit interest information for nonresident alien individuals that were residents of certain designated countries, including some (but not all) members of the European Union. The Bush administration did not finalize the revised proposed regulations and they never came into effect.

79. The other question was the relationship of European Free Trade Association countries like Liechtenstein and Switzerland to the European Union.

80. The EUSD was agreed among EU member states on June 3, 2003, and came into force on January 1, 2005. Council Directive 2003/48/EC on Taxation of Savings Income in the Form of Interest Payments, 2003 O.J. (L 157) 38, 38, 45 [hereinafter EUSD]. EU member states agreed that for the EUSD to apply to and be a meaningful enforcement measure for offshore accounts it was necessary that at least six non-EU countries (Andorra, Liechtenstein, Monaco, San Marino, Switzerland, and the United States) also comply with the EUSD. Nevertheless, they made the EUSD effective beginning in 2005, provided that Andorra, Liechtenstein, Monaco, San Marino, and Switzerland, but not the United States, met certain conditions. *Id.* at 45.

81. The EUSD's information exchange component built on foundational work done at the OECD that was intended to create a toolkit for tax administrators to adopt automatic information exchange. *See* OECD MODEL CONVENTION, *supra* note 25, art. 26.

82. Jurisdictions opting for the so-called transitional withholding tax system share the revenue with the country of residence (handing over 75 percent of receipts and keeping 25 percent of receipts). EUSD, *supra* note 80, at 44. The withholding tax option initially was assessed at a rate of 15 percent, with a schedule that increased the rate to 35 percent after June 30, 2011. *Id.* at 43. Whenever the transitional period is deemed to end, all EU member states must move to the information reporting system. *See id.* at 43 (mandating that the residual EU member states of Austria, Belgium, and Luxembourg will have to apply the information reporting system at the end of the transitional period). Technically,

adopted the information exchange regime. The three EU member states that supported bank secrecy adopted the withholding tax system, as did many of the dependent territories of the United Kingdom and the Netherlands, including the Channel Islands.[83] Switzerland agreed to cooperate with the directive as the result of a combination of substantial coercive pressure and important financial incentives (notably, Swiss companies were granted the benefits of the EU Parent-Subsidiary Directive, thereby exempting from cross-border withholding taxes dividends paid by an EU subsidiary of a Swiss company to its Swiss parent).[84] Four smaller non-EU European offshore banking centers (Andorra, Liechtenstein, Monaco, and San Marino) followed Switzerland's lead.[85] Their bilateral agreements with the European Union adopted the EUSD's withholding system but explicitly permitted Switzerland, Liechtenstein, and the smaller European offshore banking centers to maintain a withholding tax indefinitely in place of information exchange.[86] The indefinite transitional period for EU member bank secrecy jurisdictions, and the European Union's agreement to permanent anonymous withholding by Switzerland and other European offshore banking centers, created an uneasy truce between information reporting and anonymous withholding models for tax administrative assistance regarding interest income within Europe.

At one point in the current evolutionary period in cross-border administrative assistance, this truce appeared to be ending. In February 2011 the European Union adopted a roadmap to automatic information exchange among EU member

under the EUSD, the transition period ends whenever (1) there is an agreement between the European Community and the last of Andorra, Liechtenstein, Monaco, San Marino, and Switzerland to exchange information upon request on interest payments consistent with international standards (as they were then embodied in the so-called OECD Model Agreement on Exchange of Information on Tax Matters), (2) the United States commits to information exchange upon request at the same international standards, and (3) the European Council unanimously agrees that conditions (1) and (2) have been met. *Id.* Practically speaking (although perhaps not technically), conditions (1) and (2) have already been met. The real barrier is the European Council's inability to unanimously agree that the transition period is over.

83. *Id.* at 43, 45. In contrast to the arrangements with five non-EU sovereigns, discussed *infra* note 91 and accompanying text, the dependent or associated territories of the United Kingdom and the Netherlands (including the Channel Islands and various Caribbean islands) that did not agree to exchange information automatically are required to participate in the EUSD as withholding jurisdictions and to move to automatic information exchange once the transitional period ends. *Id.*

84. *See Switzerland: Year in Review*, WORLDWIDE TAX DAILY, Dec. 29, 2005, *available at* LEXIS, 2005 WTD 249-5.

85. *See, e.g.*, Agreement Between the European Community and the Principality of Monaco Providing for Measures Equivalent to Those Laid Down in Council Directive 2003/48/EC, 2005 O.J. (L 19) 55.

86. *See, e.g.*, Agreement Between the European Community and the Swiss Confederation Providing for Measures Equivalent to Those Laid Down in Council Directive 2003/48/EC, 2004 O.J. (L 385) 30; *see also* EUSD, *supra* note 80, at 45.

states for categories of income other than interest.[87] Unlike the EUSD, the Directive on Administrative Cooperation in the Field of Taxation does not mandate a given EU member state to participate in broader automatic information exchange within the European Union, let alone provide incentives to encourage any country outside the European Union to participate. It does provide, however, that the European Commission must submit proposals to the European Council before July 1, 2017, regarding the categories of capital and income that member states should be mandated to report to one another, with one aim being to extend that list to include capital gains, dividends, and royalties.[88] If the European Council were to require mandatory information reporting on these categories of income, in addition to interest reported through the Savings Directive, EU information reporting would generally overlap with the income reporting, but not the asset reporting, required under FATCA.

2. The OECD

In 2006 the Committee on Fiscal Affairs of the OECD (CFA), which brings together the senior international tax official of each OECD member state, agreed to work with many of the major global cross-border financial institutions on a project to improve the process by which portfolio investors may claim reduced source-country withholding tax rates under tax treaties.[89] Conceptually, the substan-

87. February Directive, *supra* note 41. The February Directive generally requires that, beginning January 1, 2014, each member state's competent authority automatically reports to other member states whatever information the communicating member state has available regarding income from employment, director's fees, pension income, life insurance products not covered by other EU legal instruments on information exchange and other such measures, as well as income from immovable property. *Id.* at 6. Under the February Directive, member states that do not wish to receive information can opt out (for now) of both reporting and receiving information. *Id.* The February Directive also provides that limitations on the application of European Union Directive 95/46/EC ("Data Protection Directive," related to European data protection laws) are necessary and proportionate in the case of tax information exchange and cooperation in light of the potential revenue loss for member states and the crucial importance of the February Directive in an effective fight against fraud. *Id.* at 11–12. Thus, an EU data subject's right to information about the use of his or her personal data, access to that data, and judicial remedy for breach of his or her rights under the Data Protection Directive is restricted for purposes of obtaining information exchange among the member states. *Id.* The potential conflict between EU data protection law and the crucial needs of non-EU tax authorities in a globalized economy is beyond the scope of this Article.
88. *Id.* at 6.
89. The OECD's Committee on Fiscal Affairs (CFA) is the world's leading multilateral body in international tax policy.

tive objective was to recommend for countries to develop systems akin to the QI system.[90]

The 2008 tax evasion scandals and the consequent shift in the focus of OECD tax administrations from source-country taxation to residence-country taxation of offshore assets rocked the foundations of the OECD's project. The resulting report of the Informal Consultative Group (the ICG Report) addressed one of QI's major perceived shortcomings: that it intentionally leaves customer-specific information about the beneficial owner of any given payment at the level of the financial institution closest to the customer such that source countries never receive that information and therefore can never provide it to residence countries.

The ICG Report recommended that OECD countries develop systems similar to QI.[91] Taking the example provided in Part II.A as a starting point, under the system proposed in the report (the ICG system), Singapore Bank A would inform Singapore Bank B as to what tax rate should apply to the earnings on the Indian national's investment in the United States (without revealing that investor's identity). Unlike under the QI system, however, Singapore Bank B would also route information directly to the IRS regarding the Indian national's identity and return on investment (as long as the investment was of a type that benefitted from a reduced rate of withholding under the system). The IRS could then, in principle, route this information to India. The additional reporting therefore represents a pro-residence-country compliance modification of the QI system and abandons the anonymous withholding component of QI.[92] Financial institutions from Asia, Europe, and North America strongly endorsed the ICG Report, making clear their willingness and ability to serve as cross-border tax intermediaries.

The ICG system was developed based on the principle of consensus between governments and financial institutions and relied exclusively on positive incentives rather than penalties for financial institution participation. The ICG system could ask only so much of financial institutions in exchange for these incentives. The ICG system's consequent focus on reporting in exchange for benefits for investors limited the potential benefit of reporting to residence countries to information on the kinds of payments, like dividends, that benefit from a reduced rate of tax withholding. Many kinds of cross-border investment income, such as capital gains

90. The CFA's project also included a component intended to facilitate claiming tax treaty benefits for income earned by collective investment vehicles. That component of the project was brought to a successful conclusion in 2009.

91. OECD, ICG REPORT, *supra* note 66, at 2–3. Like QI, these systems would allow authorized financial institutions to contract with governments to make tax treaty withholding relief claims on behalf of their customers on a pooled basis.

92. *See id.*

and certain interest income, generally are not subject to source-country taxation and therefore withholding. This means they are not implicated by or reported in a QI-like system. While recognizing the limitations of the ICG system as a means to address residence country concerns, senior international tax officials of the OECD governments decided to further develop the ICG system through an initiative known as the Treaty Relief and Compliance Enhancement (TRACE) project.

Alongside the TRACE project, the OECD continues its ongoing work to create information technology standards for automatic information exchange between governments to support residence-based taxation. This OECD effort includes well-developed standards for capturing, exchanging, and processing information in an automatic matching system. As a result of the OECD's technical standards, a variety of jurisdictions have made advances in recent years toward automatic information exchange between governments on an electronic basis that can be matched against resident taxpayer records.

The OECD was also instrumental in facilitating the 2010 revision of the Multilateral Convention. The Multilateral Convention's stated objective is to enable each party to the convention to counter international tax evasion and better enforce its national tax laws, while simultaneously respecting the rights of taxpayers.[93] In 1988 the convention was opened for signature by the fifty-four countries that are members of the Council of Europe, the OECD, or both. The 1988 convention proved to be of limited applicability and no practical import.[94] In 2010, however, based on a request of the 2009 G20 summit,[95] the Multilateral Convention was amended to incorporate OECD Model Tax Convention standards for tax information exchange, and membership was opened up to all countries, with particular emphasis placed on including developing economies so that they might benefit from a "new cooperative international tax environment."[96] The convention now provides a general legal framework under which automatic

93. OECD & COUNCIL OF EUR., THE MULTILATERAL CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS: AMENDED BY THE 2010 PROTOCOL (2011) [hereinafter OECD & COUNCIL OF EUR., MULTILATERAL CONVENTION], *available at* http://dx.doi.org/10.1787/9789264115606-en.

94. *Id.* (acknowledging that the Multilateral Convention appeared to be a novel step forward in multilateral tax cooperation when agreed in the 1980s but was thereafter disregarded and left almost entirely unused even by its signatories).

95. *The Convention on Mutual Administrative Assistance in Tax Matters–Background*, OECD.ORG (June 4, 2010), http://www.oecd.org/document/2/0,3746,en_2649_33767_44886082_1_1_1_1,00.html. U.K. Prime Minister Gordon Brown, as then-chair of the G20, indicated in a letter to the OECD that "it would be helpful, in this regard, if an effective multilateral mechanism could be developed." *Id.* (internal quotation marks omitted).

96. APRIL 2009 LONDON COMMUNIQUÉ, *supra* note 11, at 5.

cross-border tax information exchange could, in principle, be established among a broad range of sovereign participants.

3. FATCA

In 2010, following the UBS scandal and President Obama's campaign commitment to crack down on offshore tax evasion,[97] the U.S. Congress enacted sections 1471 to 1474 (generally known as FATCA[98]) of the Internal Revenue Code. Under FATCA, foreign financial institutions are generally required to report information on financial accounts of U.S. persons and foreign entities with significant U.S. ownership (U.S. accounts) directly to the IRS beginning in 2014.[99] Foreign financial institutions must report the account balance or value of each U.S. account[100] and the amount of dividends, interest, other income, and gross proceeds from the sale of property credited to a U.S. account.[101] The rules are intended to provide reporting both on accounts held directly by individuals and on interests in accounts held by shell entities for the benefit of U.S. persons.[102]

Congress explained that in enacting FATCA, it intended to "force foreign financial institutions to disclose their U.S. account holders or pay a steep penalty for nondisclosure."[103] Accordingly, FATCA imposes a withholding tax[104] on the

97. *Id.*
98. Sections 1471 to 1474 of the Internal Revenue Code were enacted in the Foreign Account Tax Compliance title (Title V) of the Hiring Incentives to Restore Employment Act of 2010 (HIRE Act), Pub. L. No. 111-147, §§ 501–535, 124 Stat. 71, 97–115. An earlier version of the Foreign Account Tax Compliance title of the HIRE Act was introduced in Congress as the Foreign Account Tax Compliance Act. The acronym FATCA stuck with these provisions.
99. The statutory effective date is January 1, 2013, but as of the fall of 2012 regulatory guidance had effectively delayed implementation of FATCA by one year. Chapter 4 Implementation Notice 2011-53, 2011-32 I.R.B. 124, 2011 WL 2741154. U.S. accounts are technically defined as financial accounts that are held by specified U.S. persons or U.S.-owned foreign entities. I.R.C. § 1471(d)(1)(A) (Supp. V 2011). Financial accounts are broadly defined to pull in interests in hedge funds, private equity funds, and other investment arrangements.
100. I.R.C. § 1471(c)(1)(C).
101. *See* Regulations Relating to Information Reporting by Foreign Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities, 77 Fed. Reg. 9022 (Feb. 15, 2012) (to be codified at 26 C.F.R. pts. 1, 301).
102. For this purpose a "U.S. person" generally includes any citizen or resident of the United States. The term "specified U.S. person" excludes various types of entities from the scope of the provision. I.R.C. § 1473(3).
103. HIRE Act, 156 Cong. Rec. S1745, S1745 (daily ed. Mar. 18, 2010) (statement of Sen. Levin).
104. In a conventional withholding tax, withholding on a given payment is associated with a given taxpayer's U.S. income tax liability or potential U.S. income tax liability in connection with the payment with respect to which withholding is imposed. FATCA is not a conventional withholding tax. Although nominally labeled a "tax," it is better understood as a penalty regime intended to force foreign financial institutions to disclose information to the IRS.

gross amount of certain payments from U.S. sources and the proceeds from disposing of certain U.S. investments (withholdable payments) on foreign financial institutions that do not comply and become a "participating foreign financial institution."[105] This withholding tax also applies to certain other payments to the extent that the funding for those payments may be attributed to withholdable payments ("passthru payments").[106] Importantly, this withholding tax is not limited to payments to U.S. persons. In other words, if foreign financial institutions will not agree to report to the United States on income earned by U.S. persons through accounts at those institutions, FATCA requires withholding on a wide range of payments from the United States to those same financial institutions, regardless of whether the payments are beneficially owned by U.S. persons on which the IRS wants reporting, by non-U.S. customers of the institution, or by the institution itself.[107] Section 1471 also requires participating foreign financial institutions to withhold on payments to nonparticipating foreign financial institutions. It thus was intended (1) to induce foreign financial institutions that are investing in or through participating financial institutions, but that are not investing in the United States, to also agree to participate in FATCA,[108] and (2) to disincline participating

105. More technically, withholdable payments generally include any payment of fixed or determinable annual or periodical income, if such payments are from sources within the United States, and gross proceeds from the sale or other disposition of any property of a type that can produce interest or dividends from sources within the United States. I.R.C. § 1473(1)(A).

106. The term "passthru payment" means any withholdable payment or other payment to the extent attributable to a withholdable payment. I.R.C. § 1471(d)(7). As part of the foreign financial institution (FFI) Agreement, Section 1471 requires participating FFIs to deduct and withhold a tax equal to 30 percent of any passthru payment that is made by the participating FFI to a recalcitrant account holder or a nonparticipating FFI. I.R.C. § 1471(b)(1)(D)(i). The U.S. Treasury has effectively turned off passthru payment withholding by means of delaying passthru payment withholding, other than withholding on withholdable payments, by regulation and by effectively removing the concept of passthru payment withholding from its model intergovernmental agreement. *See* I.R.S. Notice 2011-34, at 2–3, 2011-1 C.B. 765, *available at* http://www.irs.gov/pub/irs-drop/n-11-34.pdf; MODEL INTERGOVERNMENTAL AGREEMENT, *supra* note 4, arts. 4(1)(e), 6(2). The statute defines recalcitrant account holders as those account holders that fail to comply with reasonable requests for information by a participating FFI in order for it to meet its reporting obligations under an FFI Agreement or that fail to provide a waiver in any case in which any foreign law would (but for such waiver) prevent the reporting of any information an FFI is required to report under its FFI Agreement. I.R.C. § 1471(d)(6).

107. I.R.C. § 1471.

108. *See supra* note 100 and accompanying text. When an FFI is not acting as a custodian or nominee and is not a tax-transparent entity receiving payments on behalf of its members, payments that the FFI makes to account holders (including investors in its equity or debt instruments) would be treated under generally applicable U.S. tax principles as non-U.S.-source income of those account holders and therefore would not be "withholdable payments." Thus, in the absence of a passthru payment concept, the many FFIs that do not do business directly in U.S. securities, and their account holders, would generally fall outside the scope of FATCA.

foreign financial institutions from doing business with nonparticipating financial institutions because business between participating and nonparticipating financial institutions may require withholding under U.S. law. Through the passthru payment mechanism, FATCA as legislated tried to use the combined weight of U.S. financial markets and financial institutions that must, as a practical matter, do business in the U.S. marketplace as leverage with other foreign financial institutions to ensure near-comprehensive participation in FATCA's cross-border information reporting.[109] It is clear, however, that the United States could neither implement broadly applicable passthru payment withholding nor achieve near-comprehensive financial institution participation through unilateral measures alone.

A related difficulty is that as legislated, FATCA's reporting is also unilateral; it benefits the United States alone, while putting significant burdens on foreign financial institutions. Furthermore, FATCA as legislated routes information reporting directly to the U.S. government and could be understood to require closure of certain account holders' accounts, withholding on payments made by a foreign financial institution to account holders and other foreign financial institutions, or both. As a result, compliance with FATCA may require foreign financial institutions in many jurisdictions to violate contractual relationships as well as data protection, bank secrecy, or other laws of the jurisdiction in which they are located.[110] Beginning with her first major public address on these issues on December 16, 2011, Emily McMahon, the Acting Assistant Secretary for Tax Policy at the U.S. Department of Treasury, acknowledged the difficulties associated with FATCA's unilateral approach. She stated that the United States could not ask foreign financial institutions to report to the United States routinely if the United States did not routinely collect certain information on nonresidents from domestic financial institutions that it could provide to cooperating foreign sovereigns.[111] She went on to suggest that the United States was committed to enter-

109. The coercive force of FATCA's withholding mechanism is also important as a vehicle to bring in nontraditional financial institutions such as private equity funds, hedge funds, and insurance companies.

110. *See, e.g.*, Letter From Faye M. Polayes, Tax Counsel, HSBC N. Am., to Manal Corwin, Int'l Tax Counsel, U.S. Dep't of the Treasury, Michael Danilack, Deputy Comm'r (Int'l), IRS, and Steve Musher, Assoc. Chief Counsel, IRS (June 7, 2011), *available at* http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_HSBC_060711_WithCopyright_062311.pdf; *see also infra* notes 114–115 and accompanying text.

111. Emily McMahon, Acting Assistant Sec'y, U.S. Treasury, Keynote Address at the George Washington University Law School & I.R.S. Conference: Current Issues in International Taxation (Dec. 16, 2011) (notes on file with author) (speaking at a conference widely viewed as one of the premier annual gatherings of U.S. international tax practitioners and government tax officials, with

ing into bilateral and multilateral agreements that would allow financial institutions to comply with FATCA without violating local law.[112] Finally, McMahon described FATCA as a vehicle to achieve a transition to a multilateral system.[113]

Then in February 2012 the Treasury Department issued a joint statement (Joint Statement I) with France, Germany, Italy, Spain, and the United Kingdom providing for an intergovernmental approach to FATCA implementation.[114] The joint statement acknowledged that FATCA "has raised a number of issues," including that financial institutions in the European joint statement countries "may not be able to comply with the reporting, withholding and account closure requirements because of legal restrictions."[115] The framework adopted in Joint Statement I is accordingly based on reporting by financial institutions to the tax authority of the country in which they are located, followed by reciprocal automatic information exchange between governments.[116] Thus, non-U.S. financial institutions would report information on U.S. persons to the country in which the institution resides and then have the information transferred to the United States by the foreign sovereign, and vice versa. That routing mechanism, in contrast to FATCA's statutory direct, one-way reporting to the IRS, would resolve the conflict of law issues largely by bringing the United States into line with the routing mechanism of the EUSD.

Joint Statement I also suggested that the six governments would develop a shared approach to incentives, reporting, and customer identification. For example, with respect to incentives (and mandates), the joint statement provides that the framework for an intergovernmental approach would also include a practical and effective alternative approach to achieving the policy objective of passthru payment withholding.[117] As described above, that policy purpose is to ensure (by means of coercion) near-comprehensive participation by financial institutions in an automatic information reporting system. Joint Statement I thus suggested that a shared

over 700 international tax lawyers in attendance). In 2011 the Obama administration proposed regulations that would require U.S. financial institutions to collect and report to the IRS bank deposit interest information for all nonresident alien individuals, whatever their country of residence.

112. Alison Bennett, *U.S. Open to Intergovernmental Approach To FATCA Information Sharing, Official Says*, DAILY TAX REP., Dec. 19, 2011, at G-11.

113. *See* McMahon, *supra* note 111; *see also* John Herzfeld, *Financial Institutions: FATCA Rules in Final Review Stages; McMahon Notes Billions in Offshore Yields*, DAILY TAX REP., Jan. 25, 2012, at G-4 (reporting McMahon making the same point and observing that FATCA "cannot be the end of the story").

114. Joint Statement I, *supra* note 4.

115. *Id.*

116. *Id.*

117. *Id.*

approach to incentives (which could also be described as "defensive measures") was under consideration to ensure that other countries and institutions join an automatic information exchange system. The joint statement similarly provided for the development of common "reporting and due diligence standards."[118] Joint Statement I and the Treasury's public statements represented a substantial multilateral turn for FATCA implementation, given that the statute itself adopts a distinctly unilateral approach.

Then, in June 2012 the United States and Switzerland issued a joint statement (Joint Statement II)[119] that generally provided for Swiss financial institutions to report on consenting U.S. account holders directly to the IRS and report on nonconsenting U.S. account holders on an aggregate basis consistent with FATCA rules. Switzerland then agreed to provide information exchange upon request with respect to such ascertainable groups. Unlike the anonymous withholding agreements with countries like Germany and the United Kingdom, the Swiss–U.S. agreement will not provide the United States with information on the jurisdictions to which U.S. account holders most commonly choose to move those untaxed assets in advance of the FATCA effective date. Joint Statement II represents a victory for the United States standing alone in that Switzerland accepted a modified form of FATCA compliance. On the other hand, Joint Statement II may represent an effective Swiss rearguard action against multilateral automatic information exchange in that it (1) continues to reject automatic information exchange in principle, (2) largely defuses the coercive force of FATCA withholding as a source of pressure that might help obtain automatic information exchange from Switzerland for other jurisdictions, and (3) allows Switzerland to continue promoting an anonymous withholding alternative to other countries that are able to pressure it for enhanced cooperation.

The EU, OECD, and the original, purely legislative U.S. approaches to cross-border tax information exchange are challenging to reconcile because they inconsistently address identification, reporting, scope, verification, routing, and incentive

118. *Id.*

119. Joint Statement II, *supra* note 6. On the same date, the United States issued a similar joint statement with Japan. Press Release, U.S. Treasury Dep't, Joint Statement From the United States and Japan Regarding a Framework for Intergovernmental Cooperation to Facilitate the Implementation of FATCA and Improve International Tax Compliance (June 21, 2012), http://www.treasury.gov/press-center/press-releases/Documents/FATCA Joint Statement US-Japan.pdf. Like Joint Statement II, the joint statement with Japan creates a mechanism for Japanese financial institutions to provide information about U.S. account holders to the IRS in order to comply with FATCA without necessarily committing the Japanese government to developing more extensive mechanisms for cooperation with the IRS that might facilitate broader automatic information exchange. *Id.*

issues, while also presenting different models of inter-nation cooperation. Part IV returns to these inconsistencies and makes some observations on how they can be reconciled. The key point at this juncture is that the shared commitment to information exchange sets TRACE, the EUSD, and FATCA apart from the anonymous withholding alternative that the Swiss government has aggressively promoted.

C. Anonymous Withholding: The Swiss Approach

Switzerland's substitute for the tax information reporting models provided by the European Union, the OECD, and the United States has gained significant traction. Swiss financial institutions largely developed the approach and the Swiss government subsequently adopted it.[120] It provides for anonymous withholding and regularization of untaxed assets for residents of key Swiss trading partners, it is intended to substitute for cross-border automatic tax information exchange with respect to non-Swiss residents holding Swiss accounts, and it is justified as a means to protect the financial privacy of account holders.[121] Its fundamental objective is to ensure that automatic tax information exchange does not take hold as a global system.

120. *See infra* note 148 and accompanying text. In February 2011 the CEO of the Swiss Bankers Association (SBA) reported with satisfaction that the Swiss government had adopted the SBA's strategy and was implementing that strategy efficiently. Claude-Alain Margelisch, *Foreword* to SWISS BANKERS ASS'N, WEALTH MANAGEMENT IN SWITZERLAND: STATUS REPORT AND TRENDS 2, 2 (2011), *available at* http://www.swissbanking.ch/en/20110107-bro-vermoegensverwaltungsgeschaeft-rva.pdf.

121. This Article does not focus on arguments around client privacy. Those who claim, however, that financial institutions should not report information to the government of a country in which a client resides for financial privacy reasons must argue either (1) that bank secrecy vis-à-vis tax administrations is part and parcel of a basic right to privacy and that the information reporting/information availability model for tax enforcement in almost every major developed economy is thus unjust, (2) that individuals who have the wherewithal and sophistication to bank internationally should have access to elective bank secrecy, or (3) that bank secrecy needs to be preserved vis-à-vis authoritarian and corrupt regimes. The first of these arguments rejects longstanding legal and policy notions in every major developed economy that tax administration access to resident taxpayer financial information is consistent with a taxpayer's reasonable expectations of privacy. The second argument is entirely untenable; there is no credible basis for arguing that having sufficient wealth or sophistication to access offshore banking should give an individual the right to bank secrecy. The third argument conflates the idea that the benefits of a multilateral information exchange system should not be extended to all governments with the proposition that any individual, regardless of whether he or she resides in a just or unjust, democratic or undemocratic, or morally legitimate or illegitimate state, should have the option to elect individually to evade his or her taxes securely.

Austria, Germany, and the United Kingdom (each a partner country) recently signed treaties with Switzerland based on this approach and thus will each become a Swiss partner country if those treaties come into force.[122] Further, Greece and Italy are reported to be negotiating such agreements with Switzerland.[123] At one point the French parliament also asked the French finance ministry to study such an agreement.[124] Such agreements are important because Switzerland is the world's most important offshore asset management center (managing approximately 27 percent of the world's offshore wealth)[125] and is also the headquarters for certain systemically important global financial institutions (for example, UBS and Credit Suisse). Switzerland also has the power to lead other offshore asset management jurisdictions by its example, and it has done so in the past.[126] The agreements therefore have dealt a significant blow to the emergence of automatic cross-border information reporting and will deliver a further blow if they are ratified.[127] The agreements provide that investment income and capital gains of partner country residents with Swiss deposits or accounts will be taxed by Switzerland at agreed-upon rates that vary by country and category of income, with the proceeds remitted

122. *See generally* Austria–Switz. Cooperation Agreement, *supra* note 5; U.K.–Switz. Cooperation Agreement, *supra* note 15; Ger.–Switz. Cooperation Agreement, *supra* note 15.

123. *Greece Seeks Withholding Tax Agreement With Swiss*, STEP J. (Oct. 31, 2011), http://www.stepjournal.org/news/news/secondary_news/greece_seeks_withholding_tax_a.aspx; *see also* Christiane Schlötzer, *Die Spur der Scheine* [The Track of the Bills], SÜDDEUTSCHE.DE (Apr. 28, 2012), http://www.sueddeutsche.de/wirtschaft/steuerabkommen-zwischen-schweiz-und-griechenland-die-spur-der-scheine-1.1344218 (Ger.); Giuseppe Fonte, *Italy Senate Urges Swiss–Italy Tax Deal*, REUTERS (Sept. 16, 2011), http://www.reuters.com/article/2011/09/16/italy-tax-idUSL5E7KG2VH20110916. Italy's Prime Minister declared the possibility of negotiating a similar agreement with Switzerland if certain conditions are met. Armando Mombelli, *Segnali di disgelo nella vertenza fiscal* [Signs of Thaw in Tax Dispute], SWISSINFO.CH (May 3, 2012), http://www.swissinfo.ch/ita/politica/Segnali_di_disgelo_nella_vertenza_fiscale_.html?cid=32616442 (It.).

124. As of late November 2011, French Budget Minister, Valérie Pécresse, opposed a similar agreement with Switzerland. *France Has a "Choice" on Tax Says Calmy-Rey*, SWISSINFO.CH (Nov. 25, 2011, 9:11 AM), http://www.swissinfo.ch/eng/politics/France_has_a_choice_on_tax_says_Calmy-Rey.html?cid=31636338.

125. BOS. CONSULTING GRP., *supra* note 1, at 13.

126. *See, e.g.*, notes 82–84, *infra*, and accompanying text.

127. *But see* Matthew Allen, *Rubik Tax Treaties Face Serious Hurdle*, SWISSINFO.CH (Nov. 25, 2011, 1:33 PM), http://www.swissinfo.ch/eng/Specials/Rebuilding_the_financial_sector/Spotlight_on_banking_secrecy/Rubik_tax_treaties_face_serious_hurdle.html?cid=31638262 (noting that France has "closed the door" on an anonymous withholding agreement and describing the EU Commission's legal objection to anonymous withholding); *Steuerabkommen mit der Schweiz?—Italien winkt (noch) ab* [*Tax Treaty With Switzerland?—Italy (Still) Demurs*], SCHWEIZER FERNSEHEN [SWISS TV] (Dec. 8, 2011, 12:58 AM), http://www.tagesschau.sf.tv/Nachrichten/Archiv/2011/12/08/Schweiz/Steuerabkommen-mit-der-Schweiz-Italien-winkt-noch-ab (Ger.) (noting that Prime Minister Monti previously suggested that the Italian government did not intend to enter into a tax agreement with Switzerland on the model of Bern's agreements with Germany and the United Kingdom).

anonymously to the partner country.[128] The agreements specify that once Swiss financial institutions impose the withholding tax, the investor's tax obligation to the partner country will be fulfilled.[129] Partner country residents with Swiss bank accounts will not have any tax liability or information reporting obligation to the partner country on income or capital gains with respect to which the anonymous withholding tax is imposed.[130]

Partner country residents that held Swiss accounts in the past and choose to keep those accounts after May of the year the agreement enters into force will generally be charged a one-time lump sum by the Swiss institutions that hold their accounts and be subject to anonymous withholding on future dividends, interest, and capital gains.[131] The one-time charge on existing assets of account holders resident in the partner country varies from between 15 percent to 41 percent of the assets in question.[132] This one-time charge is intended as a rough proxy to compensate for past tax evasion. A one-time charge to address the past should be sepa-

128. The German and Austrian agreements specify that the Swiss will impose the same tax rate applicable to investment income and capital gains earned by German and Austrian residents through any institution that does not impose anonymous withholding, while the U.K. agreement provides for rates slightly below the regular U.K. rates on the relevant categories of income.

Thus, the Swiss–U.K. agreement generally provides that future investment income and capital gains of U.K. residents with Swiss deposits or accounts will be taxed by Switzerland at a rate of 40 percent on dividend income, 48 percent on interest income and other investment income, and 27 percent on capital gains. *See* U.K.–Switz. Cooperation Agreement, *supra* note 15, art. 19(1); U.K.–Switz. Protocol Amendment, *supra* note 5, art. 8. The German–Swiss agreement specifies a tax rate of 26.375 percent for investment income and capital gains, in line with the 25 percent German tax rate, plus the "solidarity surcharge." Press Release, Swiss Fed. Dep't of Fin., Switzerland and Germany Initial Tax Agreement (Aug. 10, 2011), http://www.efd.admin.ch/dokumentation/medieninformationen/00467/index.html?lang=en&msg-id=40533 [hereinafter Switzerland and Germany Initial Tax Agreement]. The Austrian–Swiss agreement foresees a 25 percent tax rate. Press Release, Swiss Fed. Dep't of Fin., Switzerland and Austria Sign Withholding Tax Agreement (Apr. 13, 2012), http://www.news.admin.ch/message/index.html?lang=en&msg-id=44130.

129. *See* U.K.–Switz. Cooperation Agreement, *supra* note 15, arts. 9(7), (12)–(13), 19(5); Ger.–Switz. Cooperation Agreement, *supra* note 15, arts. 7(6), 18(4); Austria–Switz. Cooperation Agreement, *supra* note 5, arts. 7(6), 17(3).

130. *See supra* note 129.

131. U.K.–Switz. Cooperation Agreement, *supra* note 15, art. 9; Ger.–Switz. Cooperation Agreement, *supra* note 15, art. 7; Austria–Switz. Cooperation Agreement, *supra* note 5, art. 7.

132. The one-time tax rate on assets varies based on a formula that takes into account the duration of the client's relationship with the withholding financial institution as well as the initial and final amount of the capital in the account over the period assessed under the agreements. Switzerland and Germany Initial Tax Agreement, *supra* note 128; U.K.–Switz. Cooperation Agreement, *supra* note 15, art. 9; Ger.–Switz. Cooperation Agreement, *supra* note 15, art. 7; U.K.–Switz. Protocol Letters, *supra* note 15; Austria–Switz. Cooperation Agreement, *supra* note 5, art. 7.

rated conceptually from the issues associated with an anonymous withholding system for taxing future dividends, interest, and capital gains.[133]

Under the agreements, if partner country residents move their Swiss accounts out of Switzerland prior to May 31 of the year the agreement enters into force, potentially opening replacement accounts in other offshore financial centers (including non-Swiss branches of Swiss banks), they avoid the lump-sum payment, future withholding, and disclosure of their accounts.[134] Thus, under the agreements, partner country residents can evade both taxation and disclosure if they wish. Swiss banks have agreed to guarantee Germany at least EUR 2 billion in revenue and to guarantee the United Kingdom at least CHF 500 million, regardless of how much withholding is actually assessed under the one-off assessments imposed by the agreements.[135]

Switzerland will report to the partner country the ten jurisdictions to which partner country residents who close their accounts transfer the largest volume of assets.[136] Switzerland will also tell the partner country how many of its residents moved funds out of Switzerland to those various ten jurisdictions but will not identify those people.[137] These arrangements simultaneously maintain client anonymity and encourage the partner country to pressure the jurisdictions where partner country residents move their money to provide anonymous withholding, thereby helping to further spread the Swiss approach.

The Swiss agreements assert that this bilateral system achieves "a level of cooperation which has, with regard to taxation in respect of income and gains on relevant assets an enduring effect equivalent to the outcome that would be achieved through an agreement to exchange information about such individuals on an au-

133. One could imagine a one-time charge to resolve past tax evasion combined with an automatic information reporting regime for the future. The agreements themselves in effect acknowledge that addressing the past and providing for the future are separate issues. U.K.–Switz. Cooperation Agreement, *supra* note 15, art. 10; Ger.–Switz. Cooperation Agreement, *supra* note 15, art. 9; Austria–Switz. Cooperation Agreement, *supra* note 5, art. 9. This Article does not take a position on the question of whether amnesty for the past (as opposed to compliance in the future) should require disclosure.

134. *See* U.K.–Switz. Cooperation Agreement, *supra* note 15, art. 7(1); Ger.–Switz. Cooperation Agreement, *supra* note 15, art. 5(1); Austria–Switz. Cooperation Agreement, *supra* note 5, art. 5(1).

135. *See* U.K.–Switz. Cooperation Agreement, *supra* note 15, art. 17(2); Ger.–Switz. Cooperation Agreement, *supra* note 15, art. 15(2). The agreement with Austria does not include an upfront payment.

136. *See* U.K.–Switz. Cooperation Agreement, *supra* note 15, art. 18; Ger.–Switz. Cooperation Agreement, *supra* note 15, art. 16; Austria–Switz. Cooperation Agreement, *supra* note 5, art. 15.

137. *See* U.K.–Switz. Cooperation Agreement, *supra* note 15, art. 18; Ger.–Switz. Cooperation Agreement, *supra* note 15, art. 16; Austria–Switz. Cooperation Agreement, *supra* note 5, art. 15.

tomatic basis."[138] Ratification of this declaration by major financial centers would achieve a central aim and key political goal of Swiss policy: gaining acceptance of the idea that anonymous withholding is equivalent to automatic information exchange.[139] For this reason, the Swiss press almost universally described the agreements as a major coup in Switzerland's rearguard effort to defend bank secrecy.[140]

D. A New International Regime?

It is easy to see the EU, OECD, Swiss, and U.S. approaches to cross-border tax administrative assistance as four competing systems. Yet doing so obscures a more fundamental point. At the start of the twenty-first century, neither governments nor financial institutions believed the institutions had a systematic role in quelling offshore tax evasion. Today, all the emerging systems for cross-border tax cooperation assume financial institutions will function as cross-border tax agents, whether as withholding agents or as information reporting agents. Despite the differences among these proposed systems, the fact remains that the European Union, the OECD, Switzerland, and the United States have all coalesced around this conclusion. That consensus represents a remarkable shift in global understandings. It has allowed the discourse of international tax cooperation to shift from a dispute about whether financial intermediaries should function as cross-border tax intermediaries to a dispute about how financial intermediaries should perform that role.

Financial institutions themselves appear to have accepted the inevitability of this new international regime. Whereas only a few years ago these same institutions eschewed any meaningful role in global efforts to police cross-border tax evasion, they now seek to shape the role they will play. For example, in response to FATCA, the U.S. Treasury has received hundreds of detailed submissions with comments from a variety of non-U.S. financial intermediaries, including traditional banks as well as pension funds, insurance companies, hedge funds, bond traders, and trust vehicles, and also industry associations and national chambers of com-

138. U.K.–Switz. Cooperation Agreement, *supra* note 15, art. 1; *see* Ger.–Switz. Cooperation Agreement, *supra* note 15, art. 1; Austria–Switz. Cooperation Agreement, *supra* note 5, art. 1.

139. *See, e.g.*, Press Release, Swiss Fed. Dep't of Fin., Switzerland and the UK Initial Tax Agreement (Aug. 24, 2011), http://www.sif.admin.ch/00488/index.html?lang=en&msg-id=40731.

140. *See, e.g.*, Matthew Allen, *Ist das Schweizer Bankgeheimnis gerettet?*, SWISSINFO.CH (Oct. 29, 2011, 3:16 PM), http://www.swissinfo.ch/ger/Wirtschaft/Finanzsektor_im_Umbruch/Bankgeheimnis_im_Rampenlicht/Ist_das_Schweizer_Bankgeheimnis_gerettet.html?cid=28660632.

merce.[141] The submissions consistently accept, either explicitly or implicitly, that the time has come for financial intermediaries to be cross-border tax intermediaries.[142] Financial institutions are embracing a multilateral approach, if only to best manage their compliance costs as cross-border tax intermediaries.

Thus, the British Bankers Association (BBA), although scathingly critical of FATCA in a series of comment letters to the U.S. Treasury, has noted that although FATCA is intended to combat U.S. tax evasion, the problem is a global one that can be solved only with participation by financial institutions. In what counts as a moment of shocking clarity by the standard of financial industry submissions to tax regulatory processes, the BBA, only months after FATCA was enacted, suggested that

> [i]n the longer term, we urge the U.S. and other nations to work towards an alternative global multilateral solution, where there would be reciprocal arrangements for all jurisdictions, and where information could be collected and exchanged between governments. We propose that consideration of a multilateral solution be an agenda item for upcoming meetings of the G20 since this is clearly an issue of international concern that requires a coordinated response.[143]

This proposal came from the leading association for banking and financial services in the United Kingdom, which represents banking organizations headquartered not only in the United Kingdom but also around the world. A series of other industry groups and national banking associations expressed similar sentiments

141. *See, e.g.*, Letter From Mary Richardson, Dir. of Regulatory & Tax Dep't, Alt. Inv. Mgmt. Ass'n, to Steven Musher, Assoc. Chief Counsel, Int'l, IRS, and Manal Corwin, Int'l Tax Counsel, U.S. Dep't of the Treasury: Foreign Account Tax Compliance ('FATCA') (June 29, 2010) [hereinafter AIMA Letter], *available at* http://www.bsmlegal.com/PDFs/AIMAsubmissionto USTreasuryandIRSreFATCA29June.pdf; *see also infra* notes 143–144 and accompanying text.

142. Some might describe industry endorsement of a global system as financial institutions trying to prolong the time before they will need to comply with any regime and simultaneously making lemonade out of lemons by ensuring they face only one regime. Such purported motives (which may or may not accurately reflect any given institution's motives) do not change the basic decision to endorse a multilateral regime. *See, e.g.*, AIMA Letter, *supra* note 141; *see also infra* notes 143–144 and accompanying text.

143. BRITISH BANKERS' ASS'N, NOTICE 2010-60, NOTICE AND REQUEST FOR COMMENTS REGARDING IMPLEMENTATION OF INFORMATION REPORTING AND WITHHOLDING UNDER CHAPTER 4 OF THE CODE (Oct. 29, 2010), *available at* http://www.bsmlegal.com/PDFs/FATCA_BBA_20101029.pdf; *see also* BRITISH BANKERS' ASS'N, NOTICE 2011-34, SUPPLEMENTAL NOTICE TO NOTICE 2010-60 PROVIDING FURTHER GUIDANCE AND REQUESTING COMMENTS ON CERTAIN PRIORITY ISSUES UNDER CHAPTER 4 OF SUBTITLE A OF THE CODE (June 7, 2011), *available at* http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_British_Bankers_Ass_06072011_061611.pdf.

about the importance of developing a coordinated multilateral approach for financial institutions to serve as cross-border tax intermediaries.[144]

Commentary from the financial sector regarding the OECD's TRACE project highlights the same convergence around the idea of financial institutions as cross-border tax intermediaries. Consider the submission of the Capital Markets Tax Committee of Asia (CMTCA) to the OECD's work. The CMTCA is a financial services industry body comprising major commercial banks, investment banks, securities firms, and other diversified financial services institutions operating in Asia. In its submission to the OECD, the CMTCA suggests that "cross-border information gathering and information exchange represents the new reality of the global economy."[145] It does not object to rules requiring its members to make customer and account information available to tax administrators on a routine basis for the purpose of cross-border information exchange.[146] Indeed, the CMTCA writes that "because of their unique position in the global economy, it is inevitable that financial institutions will be increasingly called upon to make such information available to tax administrators."[147] The CMTCA's submission is remarkable because it demonstrates that a leading tax-related association of major financial institutions operating in Hong Kong and Singapore—the two most important financial centers popularly understood to be resistant to cross-border tax

144. *See, e.g.*, Letter From Int'l Council of Sec. Ass'ns to Timothy Geithner, Sec'y, U.S. Dep't of the Treasury, and Douglas H. Shulman, Comm'r, IRS: Implication of the Foreign Account Tax Compliance Act (FATCA) (June 28, 2011), *available at* http://www.icsa.bz/img/letter_pdf/ICSA-FATCA-Letter-Jun-2011.pdf ("Rather than the unilateral approach taken by FATCA, we suggest that a more appropriate approach would be the development of a global framework that would allow the US and other governments to obtain information regarding income paid to citizens of their countries by foreign financial institutions which is in harmony with each jurisdiction's existing laws and does not create an excessive compliance burden for financial institutions."); Letter From the Dutch Banking Ass'n to Stephen E. Shay, Deputy Assistant Sec'y, U.S. Treasury, et al.: Comments of the Dutch Banking Association on the Foreign Account Tax Compliance Act, as Well as Notice 2010-60 and Notice 2011-34, at 1 (June 9, 2011), *available at* http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_NBV_060911_090811.pdf ("The Dutch Banking Association . . . would suggest a coordinated approach of states similar to what has been done in the area of transfer pricing, where through development of common concepts compliance efforts have been limited to a manageable position for taxpayers."); Letter From Eur. Banking Fed'n & Inst. of Int'l Bankers to Stephen E. Shay, Deputy Assistant Sec'y for Int'l Tax Affairs, U.S. Dep't of the Treasury, et al.: Comments on Notice 2010-60 Providing Preliminary Guidance on FATCA (Nov. 12, 2010), *available at* http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_EBF_IIB_FATCA_Comment_Letter_Nov12_121010.pdf (making similar comments).

145. Letter From Capital Mkts. Tax Comm. of Asia to Jeffrey Owens, Dir., CTPA, OECD (Aug. 18, 2010), *available at* http://www.oecd.org/dataoecd/40/60/46019879.pdf.

146. *Id.*

147. *Id.*

intermediation by financial institutions—has at least resigned itself to this new regime.

Finally, and as described earlier, Swiss financial institutions not only have consented to the anonymous withholding approach—they are in fact its originators. As the Swiss Banking Association pointed out in its 2009–2010 Annual Report, "The flat rate tax project represents an important element of both the Swiss Bankers Association's 2015 Financial Centre Strategy and the financial market strategy of the Swiss federal government, published in December 2009. The flat rate tax project proposal was developed in a body constituted by the Swiss banks."[148]

Together the United States, the European Union and its member states' dependencies, and the other OECD economies (including Switzerland) represent 59 percent of global gross domestic product (GDP)[149] and the management location for more than 80 percent of global financial assets.[150] The comments on the EU, OECD, and U.S. systems that endorse some form of automatic multilateral tax information exchange come from associations that represent much of the global financial industry.

The views of both private and public sector actors are thus converging around new principles and norms wherein financial institutions act as cross-border tax agents for governments. We are witnessing the birth of a new international regime for cross-border tax administrative assistance with respect to income and assets held through offshore accounts. The most basic contour of the emerging regime—financial institutions as cross-border tax intermediaries—is already established. Two other key elements remain to be determined: the nature of the cooperation required by the regime (anonymous withholding or information reporting), and the scope of beneficiaries of the regime (major financial centers and states politically bound to those financial centers, or the greater part of the world). Anonymous withholding available to a limited number of states is the more likely default result, but a broadly multilateral automatic information exchange system is the normatively preferable answer.

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148. SWISS BANKERS ASS'N, TÄTIGKEITSBERICHT 2009/2010 [2009–2010 ANNUAL REPORT] (2010), http://www.swissbanking.org/en/taetigkeitsbericht-2010.pdf [hereinafter 2009–2010 ANNUAL REPORT].

149. U.S. Dep't of State, *What Is the OECD?*, USMISSION.GOV, http://usoecd.usmission.gov/mission/overview.html (last visited Oct. 16, 2012).

150. Eighty-two percent of global financial assets (managed both domestically and offshore) are managed from France, Germany, Japan, Switzerland, the United Kingdom, or the United States. The remaining 18 percent of assets consists in significant measure of assets of a resident of one of the other OECD economies managed from within that OECD economy. SWISS BANKERS ASS'N, WEALTH MANAGEMENT IN SWITZERLAND 7 (2009), *available at* http://www.finanzplatz-zuerich.ch/portals/1/Documents/DE/Studien/Wealthmanagement2009_sbvg_0109[1].pdf.

III. ANONYMOUS WITHHOLDING VS. AUTOMATIC INFORMATION REPORTING

Automatic information reporting systems and cross-border anonymous withholding systems both clearly break from past practice and move toward a global norm of financial institutions serving as cross-border tax agents for governments. Neither system represents the most comprehensive solution to address offshore accounts, which would involve nonanonymous cross-border withholding in combination with automatic information reporting.[151] Between the two models presently under consideration internationally, however, an information reporting model is superior to an anonymous withholding model. Information reporting is substantively superior because it is able to address concerns regarding the accretion of untaxed principal, whereas withholding solutions are not. Furthermore, contrary to some conventional wisdom, anonymous withholding is not significantly cheaper, simpler, or more administrable than information reporting.

Just as importantly, cross-border anonymous withholding institutionalizes differentiated treatment of the most sophisticated taxpayers from the rest of society. In doing so, it undermines tax morale and the role that taxation can play in helping to define citizenship in a democratic polity. In contrast, information reporting can empower the tax system to act as a building block of liberal democracy. Where anonymous withholding has the effect of reducing policy flexibility and sovereign authority, information reporting preserves sovereign policy autonomy. Particularly outside the largest developed economies, these differences favor automatic information reporting.

Finally, politically speaking, anonymous withholding will not be accepted globally, whereas automatic information reporting has the capacity to develop into a global regime. Information reporting regimes could conceivably grow to serve a wide range of states, whereas anonymous withholding regimes will, at best, serve only the interests of the wealthiest states with the most influential financial centers. Despite the superiority of information reporting, if a crucial subset of major financial centers accepts anonymous withholding, anonymous withholding for a limited number of countries may become a stable equilibrium. This dynamic makes

151. *Cf.* Michael Keen & Jenny E. Ligthart, *Information Sharing and International Taxation* 3 (Tilberg Univ. Discussion Paper No. 2004-117, 2004), *available at* http://arno.uvt.nl/show.cgi?fid=12179 (suggesting that information sharing "may now be the last hope of the residence principle," observing that other policy responses to offshore tax evasion may be a step too far in terms of being perceived as intrusions on national sovereignty, and treating anonymous withholding and information reporting as substitutes for rather than complements to each other as a practical matter).

the outcomes of the current evolutionary moment crucial to the development of cross-border administrative assistance.

A. Effectiveness and Administration

1. Reaching Untaxed Principal

Automatic information reporting has the capacity to address concerns regarding the accretion of untaxed principal, which is a significant concern for tax administrators. Anonymous withholding is triggered only when interest, dividends, or capital gains are earned in a foreign account, whereas automatic information reporting can be structured both to report on income and gains and to measure the growth of principal in a foreign account. While scholarly discussions of tax evasion often focus on tax revenues lost because of untaxed investment income,[152] discussions with policymakers reveal that government officials have focused equally on the use of offshore structures to evade taxation on domestic business income of closely held businesses, with the proceeds from that evasion then being invested through offshore accounts so as to evade tax on the resulting investment income.[153] For instance, the hearings of the Permanent Subcommittee on Investigations, which served as a catalyst for recent U.S. efforts to crack down on offshore tax evasion, focused intently on exactly this kind of tax evasion.[154] U.S. Department of Justice prosecutions have similarly reflected the concern that taxpayers are evading tax by fraudulently shifting domestic taxable income offshore.[155] Tax admin-

152. *See* JANE G. GRAVELLE, CONG. RESEARCH SERV., R40623, TAX HAVENS: INTERNATIONAL TAX AVOIDANCE AND EVASION (2009), *available at* http://assets.opencrs.com/rpts/R40623_20090709.pdf; Joseph Guttentag & Reuven Avi-Yonah, *Closing the International Tax Gap*, *in* BRIDGING THE TAX GAP: ADDRESSING THE CRISIS IN FEDERAL TAX ADMINISTRATION 99 (Max B. Sawicky ed., 2005).

153. This is a conclusion the author drew following discussions with current and former government officials from Australia, Denmark, France, Germany, India, and the United States.

154. *Tax Haven Abuses: The Enablers, the Tools and Secrecy: Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Homeland Sec. & Gov't Affairs*, 109th Cong. 33, 45 (2006).

155. *See, e.g.*, Statement by Defendant in Advance of Plea of Guilty, United States v. Taylor, No. 2:08-CR-00064-TC (D. Utah Jan. 24, 2008); Statement by Defendant in Advance of Plea of Guilty, United States v. Petersen, No. 2:05-CR-00805-TC (D. Utah Jan. 18, 2008); GAO, QUALIFIED INTERMEDIARY PROGRAM, *supra* note 68, at 23 (describing the 2007 indictment of an adult entertainment mogul for using offshore companies that he owned to overstate business and personal expenses while concealing his ownership of those companies); Barton Massey, *Convicted Bank Chairman Is Key to Dozens of New Tax Haven Cases*, 19 TAX NOTES INT'L 959, 959–60 (1999); *see also Tax Haven Banks and U.S. Tax Compliance: Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Homeland Sec. & Gov't Affairs*, 110th Cong. 17–18 (2008).

istrators outside the United States share these same concerns, as demonstrated by their discussions in global forums.[156]

Understanding the prevalence of concerns regarding the fraudulent use of offshore structures to evade tax on domestic business income is imperative to a cogent evaluation of anonymous withholding. Even if all countries adopted an anonymous withholding system, it would not address or deter the use of offshore structures and specious transactions to evade tax on domestic business income. Withholding in any anonymous withholding system applies only to investment income, not contributions to principal. Thus, the Swiss agreements use a one-time charge as a proxy to acknowledge past untaxed principal but have no mechanism to help address the evasion of tax on domestic business income through offshore accounts on a forward-going basis. Furthermore, anonymous withholding exists to limit information exchange, and thus such a regime runs counter to the extensive cross-border administrative assistance necessary to ferret out tax evasion on principal. Conversely, an appropriately structured system of information exchange can call attention to the existence of assets of a domestic taxpayer that may be funded from income, profits, or gains that evaded taxation. The U.S. FATCA regime, for instance, requires annual asset reporting, including assets held by shell entities, as well as income reporting. This reporting attempts to deter and to identify patterns suggestive of the use of offshore accounts to evade tax on domestic income earned by closely held businesses.

Agreements between the United States and Switzerland over more than a decade demonstrate that nontaxation of principal is an important concern for U.S. tax administrators. Normally, the United States insists that tax treaties provide unfettered information exchange upon request,[157] but until 2010 Switzerland refused to provide information exchange upon request to any country with which it entered into tax treaties. The compromise agreed to in 1996 was that the Swiss would provide information to the United States in situations of tax fraud rather than mere

156. *See* OECD, SEOUL DECLARATION, THIRD MEETING OF THE OECD FORUM ON TAX ADMINISTRATION (2006) (expressing concern of thirty-five tax commissioners and deputy tax commissioners from OECD and non-OECD economies regarding outright fraud to conceal income and assets using offshore business entities); *see also, e.g.*, ASSEMBLÉE NATIONALE, COMMISSION DES FINANCES, RAPPORT D'INFORMATION NO. 1902, at 147–56 (2009) (Fr.), *available at* http://www.assemblee-nationale.fr/13/pdf/rap-info/i1902.pdf; Gesetz zur Bekämpfung der Steuerhinterziehung (Steuerhinterziehungsbekämpfungsgesetz) [Act to Fight Against Tax Evasion (Tax Evasion Act)], July 29, 2009, BGBL I at 2302 (Ger.), *available at* http://www.bundesfinanzministerium.de/Content/DE/Publikationen/Aktuelle_Gesetze/Gesetze_Verordnungen/040_SteuerhinterziehunsbekG_anl.pdf?__blob=publicationFile&v=3 (increasing reporting requirements for business transactions with entities in jurisdictions lacking tax transparency).

157. U.S. MODEL INCOME TAX CONVENTION, *supra* note 65, art. 26(1).

tax evasion[158] (run-of-the-mill tax evasion is not a crime under Swiss law).[159] One difficulty with this compromise was that it forced the two states to define the term "tax fraud" for purposes of the treaty.[160] The United States pressed the Swiss on this issue repeatedly, which resulted in three sequential agreements, the substance of which sheds light on U.S. tax administrators' offshore tax abuse concerns during the Clinton and Bush administrations. These agreements focused heavily on issues likely to arise through the fraudulent use of offshore structures to evade taxes on domestic business income.[161]

The most recent agreement, in 2003, highlighted U.S. Treasury concerns by outlining fourteen examples of offshore tax evasion abuses that would be treated as tax fraud.[162] Each example involved evasion of tax on domestic-source income using offshore accounts. One representative example involved an individual who operates a domestic business, forms a third-country corporation of which he is the

158. Protocol to the Convention for the Avoidance of Double Taxation With Respect to Taxes on Income ¶ 10, U.S.–Switz., Oct. 2, 1996, 27 U.S.T. 1996 [hereinafter Protocol to 1996 Convention], *available at* http://www.irs.gov/pub/irs-trty/swiss.pdf.

159. *See* Transparency Int'l Switz., *Tax Fraud and Tax Evasion*, http://www.transparency.ch/financialcentre/pages/taxfraud.php (last visited Nov. 1, 2012) ("Tax fraud is regulated by the Federal Law on Direct Federal Tax (article 186) and the Federal Law on Harmonising the Direct Taxation of Cantons and Municipalities (article 59). Tax evasion is regulated by the Federal Law on Direct Federal Tax (articles 175-180) and the Federal Law on Harmonising the Direct Taxation of Cantons and Municipalities (article 56)."); X. Ltd. gegen Eidgenössische Steuerverwaltung (ESTV) [X. Ltd. v. Swiss Fed. Tax Admin.], Bundesverwaltungsgericht [BVGE] [Federal Administrative Court] May 5, 2009, A-7342/2008 & A-7426/2008, at 33 (Switz.), *available at* http://www.odaformationpermanente.net/details/a_07342_2008_2009_03_05_t-1.pdf.

160. The history suggests that U.S. officials were not pleased with Swiss officials' initial (narrow) interpretation of the meaning of the term "tax fraud," which was defined in paragraph 10 of the protocol accompanying the 1996 Convention to mean "fraudulent conduct that causes or is intended to cause an illegal and substantial reduction in the amount of tax paid to a Contracting State." Protocol to 1996 Convention, *supra* note 158, ¶ 10.

161. The initial protocol to the 1996 Convention emphasized that "[f]raudulent conduct is assumed in situations where a taxpayer uses, or has the intention to use, a forged or falsified document such as a double set of books, a false invoice, an incorrect balance sheet or profit and loss statement, or a fictitious order or, in general, a false piece of documentary evidence." *Id.* The conduct defined as fraudulent is primarily relevant in relation to evasion of tax on business income rather than investment income. The protocol then dwells on how a state should determine "whether tax fraud exists in a case involving the active conduct of a profession or business (including a profession or business conducted through a sole proprietorship, partnership or similar enterprise)." *Id.* In 2003 the definition of "tax fraud" for purposes of the convention was clarified again, and again focused in substantial measure on examples of issues that would most likely arise in connection with evasion of domestic business income through the fraudulent use of offshore structures. Mutual Agreement Regarding the Administration of Article 26 (Exchange of Information) of the Swiss–U.S. Income Tax Convention of October 2, 1996, U.S.–Switz., Jan. 23, 2003 [hereinafter Swiss–U.S. Mutual Agreement].

162. Swiss–U.S. Mutual Agreement, *supra* note 161.

disguised owner, and maintains an offshore bank account in the corporate name.[163] The business enters into a contract with the corporation under which the corporation agrees to perform services for the business. Such services are never performed, but the business pays substantial fees for the service, and the fees are deposited into the corporation's offshore bank account. The business then records the fees as expenses on the business books and records, and because those books and records are used to prepare the individual's income tax return, his reported domestic taxable income is substantially understated.

Concern about similar abuses led the U.K. Treasury to emphasize the distinction between information reporting regimes and anonymous withholding regimes in deterring tax evasion on domestic business income when it championed information exchange over anonymous withholding in the early debates over the EUSD at the turn of the twenty-first century. The U.K. Treasury noted that an information exchange system can deter taxpayers from concealing business income through offshore structures, while "[e]ven if withholding arrangements were adopted by all countries globally, this would not provide an effective solution to evasion," because such systems would not "deter and detect the 'laundering' of the proceeds of tax evasion through investment abroad."[164]

2. Administrability

Another argument in favor of anonymous withholding is that even if automatic information reporting is a substantively preferable system, anonymous withholding is less costly and more administrable. This claim is grossly overstated. Anonymous withholding and automatic information reporting share almost all the same operational challenges. A multilateral anonymous withholding system along the lines of the Swiss model must (1) determine how to identify taxpayers' countries of residence, (2) collect information about amounts of interest, dividends, capital gains, and other income in order to impose the right withholding rates, (3) determine which financial institutions are included in the withholding system, (4) ensure financial institutions comply with the requirements to identify taxpayers with a country of residence and withhold appropriate amounts on iden-

163. *Id.* app. (Hypothetical 6).

164. *See* HM TREASURY, U.K., EXCHANGE OF INFORMATION AND THE DRAFT DIRECTIVE ON TAXATION OF SAVINGS ¶ 3 (2000), *available at* http://archive.treasury.gov.uk/docs/2000/eoi.html. Note that unlike the Labor government in place in 2000, the current U.K. government appears to be prepared to accept anonymous withholding. Perhaps the change of perspective is due to the United Kingdom's growing role as a major offshore asset manager.

tified types of income, and (5) determine how to encourage widespread multilateral participation. The only important aspect of information reporting that is more burdensome than anonymous withholding is its requirement for taxpayer identification numbers (TINs). On the other hand, an anonymous withholding system is more burdensome than information reporting along other dimensions. In an anonymous withholding system, a financial institution must keep track of tax rates and rate changes in different categories of income for every country in the world for which it applies withholding and then must in fact withhold, instead of simply tracking income and gross proceeds and reporting these amounts.

The only important element of a regime for cross-border administrative assistance that an information reporting system must develop more thoroughly than an anonymous withholding regime is a mechanism to transmit information from the asset management jurisdiction to the residence country in a form that tax administrations can match against residents' tax returns.[165] Assuming that a financial institution were to arrange its information technology (IT) systems to collect the necessary information to impose a withholding tax, the rate of which varies by the type of income and the customer's country of residence, providing automatic information reporting instead of withholding requires adding only two pieces to the system: TINs and IT systems that allow secure transfer of the requisite information in a mutually intelligible format. Solving the former problem requires every residence country interested in benefitting from automatic information exchange to issue its taxpayers TINs if it has not done so. It also requires every financial institution with offshore accounts to collect those numbers from nonresident account holders.[166] Solving the latter problem involves significant but feasible investment in IT development and time to implement the new technology. That much has already been demonstrated by the successful operation of the EUSD[167] as well as the work of expert groups at the OECD.[168]

165. Anonymous withholding as proposed in the Swiss agreements still requires financial institutions to be prepared to report on individual account holders (at their request), but the scale of that reporting may be small enough that it can be done manually.

166. *See* OECD, *Recommendation on Tax Identification Numbers*, *supra* note 59; *see also* David E. Spencer, *OECD Information Exchange Recommendations Are a Significant First Step in Resolving Tax Evasion*, 8 J. INT'L TAX'N 353 (1997); MODEL INTERGOVERNMENTAL AGREEMENT, *supra* note 4, art. 6(4) (providing for a reciprocal commitment to collect taxpayer identification numbers (TINs) or dates of birth).

167. *See Report From the Commission to the Council in Accordance With Article 18 of Council Directive 2003/48/EC on Taxation of Savings Income in the Form of Interest Payments*, at 2, COM (2008) 552 final (Sept. 15, 2008) (emphasizing the need for TINs and with that caveat suggesting exchange is workable through preexisting channels of communication established among EU member states).

168. *See, e.g.*, Spencer, *supra* note 166.

The Swiss Banking Association estimates the compliance cost for Swiss anonymous withholding for all financial institutions throughout Switzerland will be between CHF 300 and 500 million.[169] Further, it implies that this one-time fixed cost does not increase substantially with the number of jurisdictions for which Swiss financial institutions search for nonresident account holders. CHF 300 to 500 hundred million diffused across the industry is an expensive but manageable cost. Although the additional cost of collecting TINs and building the IT system for fully automatic routine information reporting may be significant, it is unlikely to vastly exceed the costs, which are common to automatic information exchange and anonymous withholding, of (1) identifying taxpayers and their countries of residence, (2) collecting information about interest, dividends, capital gains, and other income earned by nonresident taxpayers, and (3) ensuring financial institution compliance.[170]

Advocates of anonymous withholding often suggest that it is more administrable and less costly than information reporting by comparing the Swiss model to FATCA and noting that anonymous withholding does not require withholding on financial institutions, or on passthru payments, as does FATCA. These arguments are not on point. The withholding imposed by FATCA on financial institutions for noncompliance is not a cost of the information reporting system. Rather, it is simply the stick chosen by the United States to try to encourage global compliance. Any system with global aspirations needs a combination of carrots and sticks if it is to drive the vast majority of institutions and governments into the system. FATCA attempts to create a global regime to improve cross-border administrative assistance in the face of resistance from certain foreign sovereigns and financial institutions. It therefore requires means of coercion without which various financial institutions and sovereigns would not comply. Swiss anonymous withholding, in contrast, is intentionally characterized by contracting. It requires no coercive measures because Switzerland is not attempting to globalize the regime. Indeed, Switzerland would likely prefer to establish anonymous withholding

169. 2009–2010 ANNUAL REPORT, *supra* note 148, at 17. *But see* Letter From Dr. Jakob Schaad & Urs Kapalle, Swiss Banking Ass'n, to Manal Corwin, Deputy Assistant Sec'y of Tax Policy (Int'l), U.S. Dep't of the Treasury, Michael Danilack & Steve Musher, IRS: FATCA Notice 2011: Submission of the Swiss Bankers Association (June 10, 2011), *available at* http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_SBA_061011_NOCOPYRIGHTNEEDED_062311.pdf (complaining about the excessive cost of FATCA account identification, due diligence, and verification procedures as proposed in Notice 2010-60 and Notice 2011-34).

170. It is of course possible that the Swiss system's estimated costs are low because it does not do enough to identify tax evaders or otherwise ferret out evasion. The most important point is simply that there will not be a monumental cost differential in an apples-to-apples comparison of automatic information exchange and anonymous withholding systems.

with as few countries as necessary to stop the spread of automatic information reporting. Coercion inevitably imposes greater compliance and political costs than contracting, even if the results from coercion are justified.[171]

It is inappropriate to think of the cost of mechanisms used to encourage widespread multilateral participation among financial institutions and governments as a cost of an information reporting system rather than an anonymous withholding system. That cost is simply the cost of trying to create a multilateral system. The United States can appropriately be criticized for coercing financial institutions—by withholding 30 percent on a wide range of payments arising in or indirectly attributable to the United States—for the sake of a regime that addresses a global problem in a way that (at least initially) benefits only the United States. If such costs were imposed to ensure that automatic information reporting were available from most financial institutions in the world to most jurisdictions that complied with relevant international standards, however, the calculus regarding the cost of coercion would change. Nothing about that calculus is inherent to the choice between information reporting and anonymous withholding.

B. Governance Concerns

Tax administration plays a central role in developing national institutions. Robust tax administrations are important for national institutions more generally because they usually provide the lifeblood of a country's government.[172] Setting aside aid-dependent and rentier states, tax administrations fund all other national institutions and, as the practical expression of tax policy, represent an important component of a country's economic policy. Tax administrations also mediate more regularly between many private citizens and government than any other single government institution. The tax administration embodies and asserts a government's exclusive authority to tax and demonstrates a government's effective level of control (or lack thereof) in performing its sovereign task of gathering resources for the state.[173] For these reasons, from a state-building perspective it matters not only how much revenue a government raises but also how it raises that revenue.

171. *See* STEPHEN D. KRASNER, SOVEREIGNTY: ORGANIZED HYPOCRISY 33–40 (1999).

172. *See* Bird & Zolt, *supra* note 21, at 1631 ("A country's tax system is thus both an important and a highly visible symbol of its fundamental political and philosophical choices.").

173. *Cf.* Kyle Bagwell & Robert W. Staiger, *National Sovereignty in an Interdependent World* 1 (Nat'l Bureau of Econ. Research, Working Paper No. 10249, 2004), *available at* http://www.nber.org/papers/w10249.pdf (arguing that the capacities to exercise unilateral control over policy instruments and to operate without outside influence in internal affairs are the key features of sovereignty).

Even if anonymous withholding could be globalized (which I argue it cannot be), most countries, especially emerging economies, should prefer automatic information reporting for governance-related reasons. This claim may be controversial because anonymous cross-border withholding could theoretically provide revenue to emerging economy government fiscs without those governments needing to build an effective tax administration to collect that revenue. However, anonymous cross-border withholding on capital income threatens domestic tax morale, tends to undermine the expressive role of taxation as a building block of liberal democracy, and erodes sovereign policy flexibility. Meanwhile cross-border information reporting undergirds voluntary tax compliance and strengthens the capacity to govern.

1. Tax Morale

Compliance with domestic tax policy is quasi-voluntary; tax collection is significantly less costly and more effective if it is motivated by a voluntary willingness to cooperate ("tax morale") even while backed by coercive authority. Evidence from experimental studies and survey data suggest that tax morale is affected by factors such as citizens' perceptions of other citizens' compliance and by perceptions of the government's trustworthiness and competence.[174] This research is consistent with broader empirical research suggesting that individuals' willingness to contribute to public goods depends on whether they trust others to do the same.[175] Recent work further suggests that tax measures that increase the transparency of tax matters may help build a culture of tax compliance and thus help maximize revenue while minimizing political and enforcement-related conflict.[176] In contrast, cross-border anonymous withholding provides opacity that prevents governments from receiving the data that would suggest that they are collecting tax equitably. It sin-

174. *See* James Alm & Benno Torgler, *Culture Differences and Tax Morale in the United States and in Europe*, 27 J. ECON. PSYCHOL. 224, 228 (2006) ("[T]ax morale is likely to be influenced by such factors as perceptions of fairness, trust in the institutions of government, the nature of the fiscal exchange between taxpayers and government, and a range of individual characteristics."); Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 OHIO ST. L.J. 1453, 1477 (2003) ("[T]he development of a sense that others are contributing is likely an important factor in tax compliance.").

175. *See, e.g.*, Dan M. Kahan, *Trust, Collective Action, and Law*, 81 B.U. L. REV. 333 (2001) (discussing this research). Put another way, reciprocation hinges on contributors' perceptions that they are not being taken advantage of. *See* Lederman, *supra* note 174, at 1477; *see also* Eric A. Posner, *Law and Social Norms: The Case of Tax Compliance*, 86 VA. L. REV. 1781, 1784–85 (2000).

176. *See* Richard M. Bird, Jorge Martinez-Vazquez & Benno Torgler, *Societal Institutions and Tax Effort in Developing Countries* (Ctr. for Research, Econ. Mgmt., & the Arts Working Paper No. 2004-21, 2004), *available at* http://ssrn.com/abstract=662081.

gles out an elite class of potential nonpayers who have the sophistication to utilize foreign institutions and provides them with special treatment. A belief in equitable treatment and enforcement appears to be crucial to tax morale.

Tax compliance research also suggests that the government's level of commitment to enforcing the tax law has an important effect on voluntary compliance and tax morale.[177] If there is a widespread perception that the government is not willing to detect and penalize tax evaders, then tax evasion may be socially legitimized and tax morale will tend to fall.[178] In countries like Greece, Italy, or the Philippines, weak tax administrations lacking vigorous enforcement programs have contributed to tax evasion carrying very little moral opprobrium.[179]

Cross-border anonymous withholding arguably represents the tax administration forswearing any independent effort to collect tax that is due. It thus may legitimize nondeclaration and tax evasion with respect to income earned not only through offshore accounts but also more broadly. Thus, when the U.K. Treasury evaluated the anonymous withholding component of the so-called coexistence model for the EUSD from the late 1990s—a model that treated withholding and reporting as equally satisfactory systems—the U.K. Treasury noted that "exchange of information encourages compliance with the tax system. It provides a deterrent to the nondeclaration or under-declaration of income. In contrast a [cross-border anonymous] withholding system, without exchange of information, might appear to give the impression of legitimising tax evasion since it fails to deter nondeclaration."[180]

2. Other Political Economy Concerns and Consequences

Even in major developed economies, cross-border anonymous withholding raises concerns about the taxpayer's engagement with the polity and the equality of

177. *See* Ronald G. Cummings et al., *Tax Morale Affects Tax Compliance: Evidence From Surveys and an Artefactual Field Experiment*, 70 J. ECON. BEHAV. & ORG. 447, 456 (2009).

178. James Alm & Jorge Martinez-Vazquez, *Institutions, Paradigms, and Tax Evasion in Developing and Transition Countries*, *in* PUBLIC FINANCE IN DEVELOPING AND TRANSITIONAL COUNTRIES 146, 151 (Jorge Martinez-Vazquez & James Alm eds., 2003); *see also* Bruno S. Frey & Benno Torgler, *Tax Morale and Conditional Cooperation*, 35 J. COMP. ECON. 136 (2007) (arguing that noncompliance by other taxpayers tends to decrease a taxpayer's tax morale and compliance).

179. *See, e.g.*, Tim Lister, *Tax Evasion Is a National Pastime Afflicting Southern Europe*, CNN, Nov. 2, 2011, http://articles.cnn.com/2011-11-02/opinion/opinion_europe-shadow-economies_1_tax-evasion-tax-collection-tax-rates?_s=PM:OPINION.

180. HM TREASURY, *supra* note 164, ¶ 3.4.

citizens in the face of the taxing authority.[181] These concerns have even greater salience in many emerging and developing economies where tax evasion is frequently characterized as systemic and the taxation of elites is often a source of special concern.[182] In contrast to anonymous withholding, information reporting, like identified withholding, allows the income taxation of elites to be sufficiently visible such that it may help support the legitimacy of the governance structure in the eyes of all citizens.

When taxpayers feel they are subject to generally applicable taxes imposed by the sovereign, scholarship suggests that they are more likely to insist collectively on meaningful representation.[183] A generation of economists, economic historians, sociologists, and political scientists has been influenced by the idea that relatively broad-based and transparent taxation, especially of mobile assets, generally tends to produce more representative government.[184] On the other hand, some of these scholars suggest that external funding allowed third-world client regimes during

181. Michael Backhaus & Angelika Hellemann, *Sigmar Gabriel: "Und wir sollten die Bürger darüber abstimmen lassen," Teil 2* [*Sigmar Gabriel: "And We Should Let the Citizens Vote on It," Part 2*], BILD (Sept. 25, 2011, 12:16 AM), http://www.bild.de/politik/inland/sigmar-gabriel/wir-muessen-die-eu-reformieren-die-buerger-abstimmen-lassen-teil-2-20134564.bild.html (Ger.); *see also supra* notes 164–165 and accompanying text.

182. *See* Alm & Martinez-Vazquez, *supra* note 178, at 151; Clive S. Gray, *Enhancing Transparency in Tax Administration in Madagascar and Tanzania* (Afr. Econ. Policy Discussion Paper No. 77, 2001), *available at* http://pdf.usaid.gov/pdf_docs/PNACM656.pdf.

183. For instance, some historians explain the contrast between English liberty and French absolutism for three hundred years in part with reference to the prevalence of tax exemptions for French nobles, as compared to a transparent, direct tax burden borne relatively uniformly by the English nobility. The argument is that in England, elites were motivated to ensure a robust national assembly with meaningful authority and rule of law that constrained the executive, whereas in France, those incentives were lacking. *See* Aristide R. Zolberg, *Strategic Interactions and the Formation of Modern States: France and England*, 32 INT'L SOC. SCI. J. 687, 712 (1980).

184. *See generally* NIALL FERGUSON, THE CASH NEXUS: MONEY AND POWER IN THE MODERN WORLD, 1700–2000, at 81–106 (2001); MARGARET LEVI, OF RULE AND REVENUE (1988); Robert H. Bates & Da-Hsiang Donald Lien, *A Note on Taxation, Development, and Representative Government*, 14 POL. & SOC'Y 53 (1985); Robert H. Bates, *The Economics of Transitions to Democracy*, 24 PS: POL. SCI. & POL. 24 (1991). *See also* DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 49 (1990); CHARLES TILLY, COERCION, CAPITAL, AND EUROPEAN STATES, AD 990–1990, at 96–114 (1990); Martin C. McGuire & Mancur Olson, Jr., *The Economics of Autocracy and Majority Rule: The Invisible Hand and the Use of Force*, 34 J. ECON. LITERATURE 72 (1996); Mancur Olson, *Dictatorship, Democracy, and Development*, 87 AM. POL. SCI. REV. 567 (1993); Michael L. Ross, *Does Taxation Lead to Representation?*, 34 BRIT. J. POL. SCI. 229 (2004) (showing regressions consistent with the hypothesis that higher taxes relative to total government services make states more democratic but inconsistent with the hypothesis that higher taxes relative to income lead to democratization); James E. Mahon, Jr., *Liberal States and Fiscal Contracts: Aspects of the Political Economy of Public Finance* (Ann. Meeting of the Am. Pol. Sci. Ass'n, Conference Paper, 2005), *available at* http://citation.allacademic.com//meta/p_mla_apa_research_citation/0/4/0/1/1/pages40115/p40115-1.php.

the Cold War to avoid entering into implicit or explicit social fiscal contracts with their citizenry in which they exchanged law and representation for resources.[185] Others argue that oil wealth hinders liberal democracy because it allows oil-rich governments to avoid taxation of domestic residents and the societal bargains that come with such taxation.[186] In both examples, external funding allowed autocrats to avoid liberal democracy.

Similarly, in an anonymous withholding regime, tax collected abroad may be more akin to a source of external funding than to funding provided by citizens in a transparent relationship with their government. When domestic authorities handle tax compliance, governments are under pressure to respond to citizen demands in order to enhance tax compliance and sustain state revenues.[187] Cross-border anonymous withholding obviates the need to strengthen governance institutions to collect revenue, as it presupposes collection and remittance by a foreign financial institution under a foreign sovereign's regulatory authority. Furthermore, relying on foreign financial institutions for routine tax collection rather than on domestic withholding, information reporting, quasi-voluntary self-assessment, or some combination of all three, may reduce the capacity of compliant and visible taxpayers to bargain for law and representation in exchange for tax revenues.[188] In contrast, automatic information exchange may strengthen domestic governance institutions both by improving the capacity of domestic authorities to handle tax compliance and by forcing an interaction between government and taxpayers in order for tax to be collected.[189]

A cross-border anonymous withholding system also may undermine the role that taxation of capital income can play in providing a sense of fairness within a liberal democracy. Information reporting provides some assurance to the entire soci-

185. *See, e.g.*, TILLY, *supra* note 184, at 207–22.

186. *See* Hazem Beblawi, *The Rentier State in the Arab World*, *in* THE ARAB STATE 85 (Giacomo Luciani ed., 1990); Giacomo Luciani, *The Oil Rent, the Fiscal Crisis of the State and Democratization*, *in* DEMOCRACY WITHOUT DEMOCRATS? THE RENEWAL OF POLITICS IN THE MUSLIM WORLD 130 (Ghassan Salamé ed., 1994); Michael L. Ross, *Does Oil Hinder Democracy?*, 53 WORLD POL. 325 (2001); *see also* Thomas L. Friedman, Op-Ed., *Drowning Freedom in Oil*, N.Y. TIMES, Aug. 25, 2002, http://www.nytimes.com/2002/08/25/opinion/drowning-freedom-in-oil.html.

187. *See, e.g.*, LEVI, *supra* note 184, Mick Moore, *How Does Taxation Affect the Quality of Governance?* (Inst. of Dev. Studies Working Paper No. 280, 2007), *available at* http://www2.ids.ac.uk/gdr/cfs/pdfs/Wp280.pdf.

188. Government will tend to heed the concerns of taxpayers and attempt to achieve quasi-voluntary compliance in an information reporting system precisely because automatic information exchange will never be perfect.

189. Even when tax is enforced domestically via withholding by domestic financial institutions, domestic tax authorities must regulate the process by which withholding is imposed, which forces them to develop the capacity to oversee such withholding.

ety that tax on capital income is in fact being collected from wealthy taxpayers. A government can, for example, provide reports showing distributional breakdowns of the tax burden. In contrast, cross-border anonymous withholding can undermine the perceived legitimacy of the government by eroding the citizenry's confidence that the government is raising funds in an equitable manner.[190] In this regard, it is important to recognize that the value anonymous withholding purports to uphold, financial privacy vis-à-vis one's own government in matters of taxation, rejects the basic information reporting/information availability model for tax enforcement in almost every major developed economy.[191] Perhaps for these reasons, in discussing cross-border anonymous withholding, Sigmar Gabriel, chairman of Germany's Social Democratic Party, has suggested that the Swiss–German anonymous withholding agreement is "destroying people's sense of justice," and sending a message that "whoever is rich can buy themselves free from punishment."[192] If the transparency of taxation has any role to play in constituting the democratic experience, then moving to an anonymous withholding system to collect those taxes most likely to be associated with privilege undermines that role.

Some scholars suggest that visible, progressive taxation of capital income and closely held business income at the top of the income distribution is a necessary symbol of the commitment to fairness in a liberal democracy.[193] Others suggest

190. For instance, if anonymous withholding were commonplace it would not be possible to show accurately what part of the income tax the top 1 percent of income earners paid. *See* Margaret Levi & Audrey Sacks, *Achieving Good Government—and, Maybe, Legitimacy* (Paper Produced for the World Bank Conference, "New Frontiers of Social Policy," Dec. 12–15, 2005), *available at* http://siteresources.worldbank.org/INTRANETSOCIALDEVELOPMENT/Resources/ACHIEVINGGOODGOVERNMENT.pdf (arguing that the legitimacy of what we might consider a good government requires the citizenry to believe that the government is raising funds in an equitable manner in addition to serving the public good).

191. Against this background, concerns regarding the potential for misuse of exchanged information by tax administrators in some countries cannot serve as a justification for favoring anonymous withholding over information reporting for cross-border activities generally. *See supra* note 121. Such concerns do, however, suggest the importance of safeguards to prevent and penalize misuse of taxpayer information. *See infra* notes 240–241.

192. *See* Backhaus & Hellemann, *supra* note 181.

193. *See, e.g.*, Bird & Zolt, *supra* note 21, at 1683 (noting that "symbols matter" and that in the developing world "[a] progressive income tax, whatever its defects in practice, may be an important and sometimes critical symbol of concern with the distributive outcomes of the market system"); Maureen B. Cavanaugh, *Democracy, Equality, and Taxes*, 54 ALA. L. REV. 415 (2003); *see also* MICHAEL J. GRAETZ, 100 MILLION UNNECESSARY RETURNS: A SIMPLE, FAIR, AND COMPETITIVE TAX PLAN FOR THE UNITED STATES 54 (2008) (noting that even schoolchildren conclude that fairness in a democracy involves some degree of progressive taxation based on ability to pay). Some scholars claim that without visibly progressive taxation, public support for growth-inducing policies like free trade may fray and economic populism may become a more pronounced feature of government. *See, e.g.*, ROGER C. ALTMAN ET AL., BROOKINGS INST., PATH TO PROSPERITY: AN ECONOMIC

that imposing taxes on mobile assets in a transparent manner encourages collective bargaining with the sovereign and thus results in the emergence of more representative and classically liberal government.[194] An automatic information reporting system that identifies prosperous individual taxpayers and requires them to participate in the act of paying taxes (and perhaps encourages them to lobby to reduce those taxes) achieves both of these ends. In contrast, anonymous cross-border withholding of income tax on capital income may change the taxing relationship between the citizen and the state. At minimum, it reduces the taxpayer's awareness of a domestic fiscal process and any consequent likelihood to engage the polity to demand accountability. Beyond that, cross-border anonymous withholding may shake all citizens' confidence that the government is raising funds equitably.[195] In the context of major developed economies, the pressures on liberal democracy from anonymous withholding may be significantly less relevant. But in the context of emerging and developing economies still working to achieve robust democratic governance, these same pressures should not be underestimated.[196]

3. Maintaining Policy Flexibility

In contrast to automatic information reporting, anonymous withholding substantially reduces sovereign authority and policy flexibility, especially for less powerful states, by permanently outsourcing tax collection on capital income to foreign sovereigns and by removing unilateral control over tax policy instruments. Anonymous withholding thus threatens the organization and effectiveness of domestic administrative and political authority, as well as sovereign autonomy, understood as the capacity to exclude external actors from domestic policy decisions.

STRATEGY TO ACHIEVE MORE BROADLY SHARED GROWTH 7 (2008), *available at* http://www.brookings.edu/~/media/research/files/papers/2008/11/path to prosperity/11_path_to_prosperity; Kenneth F. Scheve & Matthew J. Slaughter, *A New Deal for Globalization*, 86 FOREIGN AFF. 34 (2007).

194. *See generally* LEVI, *supra* note 184; Bates & Lien, *supra* note 184. Niall Ferguson suggests that direct taxes on elites are positively associated with the growth of representative institutions. FERGUSON, *supra* note 184, at 81; *see also* Wilson Prichard, *Taxation and State Building: Towards a Governance Focused Tax Reform Agenda* 24 (Inst. of Dev. Studies Working Paper No. 341, 2010), *available at* http://www2.ids.ac.uk/gdr/cfs/pdfs/Wp341%20web.pdf ("The greatest challenge in improving enforcement equity, and thus strengthening the basis for collective tax bargaining, lies in improving taxation of elites. The poor enforcement of personal income taxes is in some respects the defining feature of developing country tax systems, with implications for revenue and legitimacy.").

195. *See generally* Levi & Sacks, *supra* note 190. In contrast, cross-border information reporting can provide a tool to preserve the state's role as the ultimate tax assessments enforcer.

196. *See generally* Bird, Martinez-Vazquez & Torgler, *supra* note 176.

The Swiss agreements show hints of each of these problems. Under the terms of those agreements, if a partner country adjusts its tax rates on income or gains after the agreements are signed, withholding tax imposed by Switzerland is amended by the same number of percentage points that the statutory rates are amended unless the competent authority of Switzerland decides that it will not adjust the applicable tax rates.[197] Furthermore, the treaties lock in a particular definition of income, dividends, other income, and capital gain that cannot be changed without bilateral agreement.[198] The agreements thus cede to Switzerland a measure of final authority over whether the income and gains of the partner country residents will be taxed according to the partner country's law. From a practical standpoint, it is difficult to imagine Switzerland refusing to adjust withholding rates consistent with German or British policy decisions in the medium term; Switzerland would likely refrain from such action out of fear of retaliation and a desire to see the Swiss approach accepted internationally. But when generalized to other countries, the fact that the Swiss retain even a nominal right to overrule partner country tax policy decisions with respect to partner country nationals has remarkable implications for tax sovereignty. It highlights the Swiss view that the partner country's receipt of income from their nationals investing through Switzerland is a discretionary Swiss policy decision rather than any matter of right. In principle, the Swiss agreements require jurisdictions (1) to cede a measure of their ability to assert taxing authority domestically over their residents, (2) to con-

197. U.K.–Switz. Cooperation Agreement, *supra* note 15, art. 20(2); Ger.–Switz. Cooperation Agreement, *supra* note 15, art. 19(2); Austria–Switz. Cooperation Agreement, *supra* note 5, art. 18(2). Austria, Germany, and the United Kingdom may change their tax rates applicable to income and gain, and in such instances they must inform Switzerland without delay. At that point, Switzerland has thirty days to inform the countries as to whether it refuses to adjust the rates at which it withholds anonymously by the same percentage as the rates have changed under Austrian, German, or U.K. law. U.K.–Switz. Cooperation Agreement, *supra* note 15, art. 20(2); Ger.–Switz. Cooperation Agreement, *supra* note 15, art. 19(2); Austria–Switz. Cooperation Agreement, *supra* note 5, art. 18(2). Under the agreements, Austria, Germany, and the United Kingdom are allowed to terminate the agreement with six months' notice if Switzerland does not adjust its withholding rate to correspond with a domestic U.K. rate change. U.K.–Switz. Cooperation Agreement, *supra* note 15, art. 44(3)–(4); Ger.–Switz. Cooperation Agreement, *supra* note 15, art. 43(3)–(4); Austria–Switz. Cooperation Agreement, *supra* note 5, art. 40(3)–(4). This is more flexible than the general termination rules under the agreements, which are intended to lock both jurisdictions into the agreement by requiring at least two years' notice to terminate. U.K.–Switz. Cooperation Agreement, *supra* note 15, art. 44(2); Ger.–Switz. Cooperation Agreement, *supra* note 15, art. 43(2); Austria–Switz. Cooperation Agreement, *supra* note 5, art. 40(2).

198. U.K.–Switz. Cooperation Agreement, *supra* note 15, arts. 25–28; Ger.–Switz. Cooperation Agreement, *supra* note 15, arts. 24–27; Austria–Switz. Cooperation Agreement, *supra* note 5, arts. 23–26. Note that the general two-year termination period would apply if a government chose to abandon the agreement out of concern regarding the definition of a category of income.

sider Swiss reactions when making domestic taxing decisions, and (3) to forego the option of seeking additional information from their residents.

These problems crystallize when one imagines anonymous withholding along the lines of the Swiss–U.K./German agreements in the context of an agreement between an asset management jurisdiction and a less powerful middle-income economy. A country without significant market leverage over Switzerland or other offshore asset management jurisdictions would, by entering into anonymous withholding agreements, significantly compromise its unilateral control over the appropriately domestic decisions about tax rates on domestic residents' capital income. Policymakers in such a jurisdiction would need to ask whether, if they altered their domestic taxing regime, Switzerland and every other jurisdiction providing them with anonymous withholding services would agree to go along. If such a jurisdiction were to rely on anonymous withholding, some of the resources that sustain the state would be in another sovereign's hands. Sovereign autonomy could be compromised for most countries, and over time, large asset management jurisdictions could gain significant power over many countries' tax policy choices and perhaps gain influence over other foreign policy choices as well.

More generally, an anonymous withholding regime is not compatible with a progressive income tax and benefits system. Anonymous withholding undermines the enforceability of a tax or benefits system that provides assistance (such as an earned income tax credit or unemployment support) that phases out with income or savings.[199] Further, permitting anonymous withholding is incompatible with maintaining a fully functional comprehensive income tax with graduated rates.[200] The Swiss agreements assume a jurisdiction has chosen a schedular income tax system (taxing different categories of income at fixed, flat rates) rather than a comprehensive income tax that applies a graduated rate schedule to all income or defined categories of income. In this way, anonymous withholding agreements compromise any state's authority over the domestic tax regime.

199. It would not be possible to effectively administer an earned income tax credit that is not available to those with substantial amounts of capital income in a system that permits taxpayers to avoid reporting capital income by earning it through offshore accounts. Similarly, enforcing unemployment support programs along the lines of Germany's *Arbeitslosengeld II* program requires the government to be able to determine the amount of savings held by potential claimants.

200. If a country abandons tax or other social benefits intended to be limited to residents with low levels of taxable income, then anonymous withholding systems may be imperfectly reconciled with a comprehensive income tax system that accepts overtaxation by imposing the highest marginal tax rate for any given category of income on all income in that category of income on which anonymous withholding is imposed.

A critic might acknowledge the above concerns regarding domestic policy flexibility and sovereign autonomy but dismiss them as alarmist, since there is heavy bias for home-country asset management. As described in Part I, however, the fact that today only 6.5 percent of global wealth is managed offshore[201] masks the reality that in some regions outside the most developed economies, offshore asset management is effectively the norm. For example, in Argentina, at least 47 percent of national wealth (and 74 percent of the wealth controlled by households with greater than $100,000 in managed assets) is managed offshore.[202] Further, the offshore asset management industry continues to grow. The potential for expanded growth in the context of anonymous withholding is highlighted by the fact that the Swiss–German anonymous withholding agreement was explicitly conditioned on German concessions to facilitate Swiss financial institutions' access to German customers.[203] The concessions Switzerland extracted from Germany make it easier for wealthy Germans to bank exclusively through Swiss institutions without the Swiss institution maintaining any German footprint.[204] Similar provisions are incorporated in the Swiss–Austrian agreement.[205] If, in exchange for anonymous withholding, offshore asset management jurisdictions were able consistently to extract concessions allowing them to compete legally with domestic financial institutions without having local footprints or being subject to local regulation, a further

201. *See supra* note 1.
202. BOS. CONSULTING GRP., *supra* note 1, at 12. Argentina is not unique. For instance, in Mexico from 2005 to 2010, 75 percent of the 47 percent of national wealth held by millionaire households was managed offshore. *Id.*
203. The Swiss negotiated for simplified exemptions from regulation under the German Banking Act for Swiss financial institutions that want to supply banking and financial products in Germany, and were able to eliminate the requirement either to create a subsidiary or branch in Germany or to operate in partnership with an existing German financial institution, in order to legally serve German clients. *See* Switzerland and Germany Initial Tax Agreement, *supra* note 128.
204. The German Banking Act generally provides that financial service providers from non–European Economic Area (EEA) countries (Switzerland is not in the EEA) that want to supply banking and financial products in Germany must obtain a permit to create a subsidiary or branch in Germany. Kreditwesengesetz [KWG] [German Banking Act], Sept. 9, 1998, BGBL. I at 2776, as amended, §§ 32(1), 33(1), 53(1) (Ger.). Such financial institutions are subject to the German banking rules regardless of whether they are established or resident in Germany, or are located or resident abroad but have focused on the German market to carry out business with persons who are resident or ordinarily resident in Germany. *Id.* § 32. Furthermore, client relationships with German residents must be established through a domestic financial institution. Under the agreement reached between Switzerland and Germany, the permit exemption procedure that was technically available to Swiss institutions will be simplified, and Swiss institutions' obligation to initiate legal client relationships via a local German financial institution will be eliminated.
205. Memorandum zu verfahrensrechtlichen Aspekten grenzüberschreitender Tätigkeiten im Finanzbereich [Memorandum on Procedural Aspects of Cross-Border Activities in the Financial Sector], *in* Austria–Switz. Cooperation Agreement, *supra* note 5, at 30.

shift toward offshore asset management among wealthy individuals could easily occur.

In contrast to anonymous withholding, an automatic information exchange regime would strengthen sovereign authority and thereby improve policy flexibility and governance capacity, particularly for less powerful sovereigns. Rather than constraining the set of tax policy choices a government may make, as anonymous withholding would, automatic information exchange broadens the potential for tax policies that can be consistently enforced among all residents. It allows for a more legitimate domestic political authority while reclaiming for the state authority over one important consequence of financial globalization.

C. Political Dynamics

Practically speaking, most nation-states are unlikely to provide anonymous withholding, and those that do are unlikely to provide anonymous withholding to a wide range of other nation-states. Furthermore, the proponents of an anonymous withholding system have no interest in its globalization. As explained below, for these reasons most policymakers internationally should prefer automatic information reporting to anonymous withholding because the latter cannot be globalized. Further, there will come a point when bilateral anonymous withholding arrangements will impede progress toward information reporting arrangements for all but the most economically powerful countries. In contrast, automatic information exchange solutions that initially meet the demands of developed economies can be globalized over time to provide benefits to other tax administrations as well.

The likely equilibrium for the anonymous withholding regime put forth by Switzerland would be for Switzerland to reach agreements with the large developed economies that can exert pressure for cross-border tax administrative support, neutralize the United States by moving forward with the Joint Statement II framework, and then cease to negotiate further anonymous withholding agreements with other governments. In time, pressure from the major developed economies besides the United States would likely lead other large offshore asset management jurisdictions to follow Switzerland's lead and reach anonymous withholding agreements with these states as the price of resolving conflicts with the major developed economies. By the same token, a reciprocal, broadly multilateral anonymous withholding regime in which most jurisdictions around the world agree to withhold anonymously for most other jurisdictions is highly implausible. Among other reasons, large developed economies are unlikely to agree to collect tax automatically for other, less powerful sovereigns.

1. Limited One-Way Anonymous Withholding Agreements

Switzerland's leadership recognizes that anonymous withholding in a small number of targeted agreements can diffuse pressure for Swiss information reporting to a broader group of countries.[206] Thus, in their agreements with Austria, Germany, and the United Kingdom, the Swiss insisted that those countries each commit to uphold the anonymous withholding model and not to work against it in dealings with third parties.[207] If anonymous withholding agreements are reached with each of the large financial centers other than the United States, with which the Swiss financial industry does business (and in which Swiss banks have substantial business operations), the remainder of the world's jurisdictions would be relatively powerless to put pressure on Switzerland or its banks to erode bank secrecy further or even to make anonymous withholding more widely available to other jurisdictions. Managing assets for nonresidents from most of the world would likely continue on a tax-shielded basis.

Eventually the large financial centers may be able to pressure other offshore asset management centers into anonymous withholding agreements if they so choose. The Swiss agreements appear structured to produce precisely such negotiations. Each agreement includes provisions that both allow partner country taxpayers to evade the force of the agreement by moving their assets before the effective date and also give the partner country information on the jurisdictions to which those taxpayers most commonly choose to move those untaxed assets.[208]

It is important to recognize that for any large developed economy, anonymous withholding by Switzerland alone is unlikely to deter tax evasion substantially because high-quality wealth-management services are available in many jurisdic-

206. *See* Leo Müller & Erik Nolmans, *Steuerabkommen: Daumen drücken*, BILANZ (Dec. 10, 2011), http://www.bilanz.ch/unternehmen/steuerabkommen-daumen-druecken.

207. Both agreements provide that the parties will "neither violate the provisions [of the agreement] through an unilateral act nor work against the agreed provisions in their dealings with third parties." Joint Declaration Concerning the Equivalence of This Agreement, *in* U.K.–Switz. Cooperation Agreement, *supra* note 15, *available at* http://www.hmrc.gov.uk/taxtreaties/joint-dec-equivalence.pdf; Gemeinsame Erklärung der Vertragsstaaten zur Gleichwertigkeit dieses Abkommens [Joint Declaration Concerning the Equivalence of This Agreement], *in* Ger.–Switz. Cooperation Agreement, *supra* note 15, at 44; Gemeinsame Erklärung der Vertragsstaaten zur Gleichwertigkeit dieses Abkommens [Joint Declaration Concerning the Equivalence of This Agreement], *in* Austria–Switz. Cooperation Agreement, *supra* note 5, at 27.

208. British and German residents who transfer their assets before the last day of the fifth month following the effective date of the agreement can avoid the withholding tax imposed as the default compliance provision under the treaties. *See* U.K.–Switz. Cooperation Agreement, *supra* note 15, art. 18; Ger.–Switz. Cooperation Agreement, *supra* note 15, art. 16; Austria–Switz. Cooperation Agreement, *supra* note 5, art. 15.

tions. Arrangements based on the Swiss model only ensure that dedicated tax evaders from countries with such agreements do not keep Swiss bank accounts if they wish to avoid taxation. Evaders can easily close Swiss accounts and open accounts in other jurisdictions (such as Singapore), including non-Swiss branches of Swiss banks.

The Swiss agreements state that Swiss banks will not "knowingly encourage" their current clients to use such strategies—a provision of questionable enforceability and relevance, given that the agreements both permit and anticipate the transfers.[209] Swiss banks are allowed to facilitate these asset transfers on request from current customers and to promote evasion through non-Swiss branches of Swiss banks going forward. Thus, the statistical disclosure in the Swiss agreements enables Switzerland to enlist Germany, the United Kingdom, and other governments with which it enters agreements to level the playing field for Switzerland, relative to other offshore asset management jurisdictions.[210]

If Germany and the United Kingdom were to ratify their agreements with Switzerland, they would likely be motivated to pursue further bilateral anonymous withholding agreements. After ratifying their agreements with Switzerland, they (or any other developed economies that accept the Swiss model) may find it difficult to promote or negotiate for automatic information exchange multilaterally. Having accepted the premise with Switzerland that anonymous withholding is an acceptable substitute for automatic information reporting, and having agreed not to work against the anonymous withholding model, the current German and U.K. governments may find it difficult to refuse anonymous withholding from other offshore asset management jurisdictions as a substitute for automatic information exchange. Indeed, but for the political pressure currently being exerted against ratification of the Swiss agreements, the current German and U.K. governments would seem poised to affirmatively pursue anonymous arrangements with other offshore asset management jurisdictions. This would include any negotiations with jurisdictions that Swiss data suggest are the major destinations for German and U.K. evader funds.[211] Anonymous withholding agreements between those jurisdictions and Germany and the United Kingdom would make it easier for all asset

209. *See, e.g.*, U.K.–Switz. Cooperation Agreement, *supra* note 15, art. 33.

210. Meanwhile Joint Statement II and FATCA withholding ensure a better-than-level playing field for Swiss financial institutions vis-à-vis investments in the United States, relative to countries that have not entered into a framework for cooperation with the United States to facilitate implementation of FATCA. *See* Joint Statement II, *supra* note 6.

211. *See*, *e.g.*, *supra* note 176 and accompanying text. The Labour Party in the United Kingdom and the Social Democratic Party in Germany both oppose the Swiss agreements, such that those agreements may not be ratified or, if ratified, might be terminated by a subsequent German or U.K. government.

management jurisdictions to agree to anonymous withholding for a limited set of powerful states and to reject broadly multilateral automatic information exchange. To support the development of a broadly multilateral automatic information exchange system effectively, Germany and the United Kingdom probably need to affirmatively decide not to ratify (or terminate) their agreements with Switzerland.

2. Broadly Multilateral Reciprocal Anonymous Withholding

The second conceivable steady-state solution arising from the Swiss approach is a broadly multilateral anonymous withholding regime in which jurisdictions around the world agree to withhold anonymously for one another. Such a solution is highly implausible. Offshore asset management jurisdictions have no interest in a global reciprocal anonymous withholding system. More importantly, the large developed economies would not contemplate such a system because they are uninterested in collecting tax on behalf of every other country around the world. The revenue Germany and the United Kingdom would receive through anonymous withholding from Switzerland greatly exceeds the amounts they would need to transfer to Switzerland if they were withholding on its behalf. Nevertheless, in the Swiss agreements, the partner countries agree only that Switzerland may request that measures be introduced by the partner countries that provide exchange of information from them to Switzerland, and only to the extent similar approaches are adopted by the partner country in relation to other states.[212] Switzerland represents an unusual case in which the revenue flow would be overwhelmingly in the partner country's favor. It is hard to imagine that these jurisdictions would be prepared or willing to provide anonymous withholding in the vast majority of cases, where the outflows from the partner country fisc could vastly exceed the inflows.

British and German behavior in this regard is both predictable and consistent with widely prevailing concepts of sovereignty in the tax context. In contrast to information reporting, anonymous withholding implies more than mere cooperation among governments. Rather, it requires governments to collect taxes for one another. Cross-border anonymous withholding is a form of automatic collection assistance provided to other sovereigns. In the common law countries (which represent approximately half of the world's GDP),[213] the presumption against col-

212. *See* U.K.–Switz. Cooperation Agreement, *supra* note 15, art. 36; Ger.–Switz. Cooperation Agreement, *supra* note 15, art. 34; Austria–Switz. Cooperation Agreement, *supra* note 5, art. 31.

213. M. Marshall, *World Economy Hinges on China's Bankruptcy Law, Wood Says*, VA. LAW (Mar. 16, 2005), http://www.law.virginia.edu/html/news/2005_spr/china_wood.htm.

lecting revenue for other governments runs deep, both as a policy matter and as a legal one.

Policymakers commonly understand limitations on the extent to which a nation will provide collection assistance to another nation as a straightforward application of the principle of territorially limited state sovereignty.[214] A key component of exclusive territorial authority is the unique right to impose tax on that territory. As a first-order matter, maintaining sovereignty requires the sovereign authority within a state to exclude another state from pursuing its tax claims in the home state's territory.[215] The default assumptions that stipulate appropriate behavior by a political entity therefore create a substantial presumption against collection assistance. States may agree to provide a taxing benefit on their territory to other states, but they must be provided significant incentives to do so.

Without strong contrary incentives, powerful states are highly unlikely to allow the erosion of their sovereign authority by facilitating the extraterritorial exercise of taxing power within their territory. This explains why, although the OECD Model Tax Convention has included a model provision for collection assistance in specific cases (assuming the residence country can provide all necessary information) since 2003, the official commentary describes the provision in realist terms.[216] The agreed commentary observes that during negotiations each contracting state will need to decide whether collection assistance upon request (that is, limited to specific cases) should be included in a treaty with another state based on its own instrumental motives and legal traditions.[217] The OECD Model Commentary acknowledges that even when tax debts are fully determined by the

214. *Cf.* Pasquantino v. United States, 544 U.S. 349, 379–80 (2005) (Ginsburg, J., dissenting) ("[A]s to foreign customs and tax laws, there is scant room for doubt about Congress' general perspective: Congress has actively indicated, through both domestic legislation and treaties, that it intends 'strictly [to] limit the parameters of any assistance given' to foreign nations." (latter alteration in original) (quoting Att'y Gen. of Can. v. R.J. Reynolds Tobacco Holdings, Inc., 268 F.3d 103, 119 (2d Cir. 2001))).

215. *See, e.g.*, U.N. Secretariat, Ad Hoc Grp. of Experts on Int'l Cooperation in Tax Matters, *Mutual Assistance in Collection of Tax Debts*, U.N. Doc. ST/SG/AC.8/2001/L.2 (Aug. 30, 2001); ASIF H. QURESHI, THE PUBLIC INTERNATIONAL LAW OF TAXATION: TEXT, CASES AND MATERIALS 308 (1994); Alan R. Johnson et al., *Reciprocal Enforcement of Tax Claims Through Tax Treaties*, 33 TAX LAW. 469, 469–70 (1980).

216. The United Nations Model Double Taxation Convention Between Developed and Developing Countries (U.N. Model Convention) has no collection assistance provision, although the U.N. Tax Committee is reported to have agreed to include an assistance collection provision in the next version of the U.N. Model Convention. Michael Lennard, *The UN Model Tax Convention as Compared With the OECD Model Tax Convention—Current Points of Difference and Recent Developments*, ASIA-PAC. TAX BULL., Jan./Feb. 2009, at 4, 10.

217. *Id.*

residence state, and even in the limited context of case-specific assistance, collection assistance will only be provided between sovereigns where there is an alignment of interests and a shared judgment as to mutual economic benefit.[218]

As a judicial matter, the presumption against collecting revenues for other governments even in specific cases is enshrined in what is known as the revenue rule. The revenue rule overrides what are otherwise commonly applicable norms of cross-border judicial comity and holds that a court will not give domestic effect to the taxes, fines, or penalties imposed by a foreign sovereign.[219] Although it began as a common law doctrine,[220] the revenue rule is sufficiently deeply entrenched as a default in both common law[221] and civil law jurisdictions that it is sometimes de-

218. The idea of cross-border collection assistance in some form has a longstanding place in international tax dialogue but has never made much headway. The first proposal for cross-border assistance in recovering tax claims in specific cases arose in the League of Nations. LEAGUE OF NATIONS, FISCAL COMM., LONDON AND MEXICO MODEL TAX CONVENTIONS: COMMENTARY AND TEXT 100 (1946) ("Model Bilateral Convention for the Establishment of Reciprocal Administrative Assistance for the Assessment and Collection of Direct Taxes: Mexico Draft"); *id.* at 100 ("Model Bilateral Convention for the Establishment of Reciprocal Administrative Assistance for the Assessment and Collection of Taxes on Income, Property, Estates and Successions: London Draft"). Subsequently the OECD developed the Model Convention for Mutual Administrative Assistance in the Recovery of Tax Claims in 1981. OECD, MODEL CONVENTION FOR MUTUAL ADMINISTRATIVE ASSISTANCE IN THE RECOVERY OF TAX CLAIMS: REPORT OF THE OECD COMMITTEE ON FISCAL AFFAIRS (1981). In both cases, collection assistance was limited to specific cases rather than any form of automatic withholding arrangement, let alone anonymous withholding. Neither convention ever came into force.

219. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 483 (1987) ("Courts in the United States are not required to recognize or to enforce judgments for the collection of taxes, fines, or penalties rendered by the courts of other states."); *see also id.*, reporter's note 1 (citing Holman v. Johnson, (1775) 98 Eng. Rep. 1120 (K.B.)). The sovereignty concerns underlying the revenue rule also explain why tax debts and claims are generally excluded from conventions and instruments regulating international cooperation in recognizing and enforcing legal judgments that are of general (rather than tax-specific) application. *See, e.g.*, Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, art. 1, Sept. 27, 1968, 1998 O.J. (C 27) 4; Council Regulation 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, 2001 O.J. (L 12) 2 (EC) (excluding revenue, customs, and administrative matters from its scope of application via article 1.1 of that regulation). *But see* European Convention on Mutual Assistance in Criminal Matters art. 1, Apr. 20, 1959, 472 U.N.T.S. 185 (allowing assistance in processing fiscal offences).

220. The rule as known at common law dates at least to *Attorney General v. Lutwydge*, a 1729 English court case that held that the court could not enforce a bond executed in Scotland to enforce Scottish import duties on tobacco because the obligation was a foreign tax obligation. Att'y Gen. v. Lutwydge, (1729) 145 Eng. Rep. 674 (Ex. Div.); *see, e.g.*, Ludlow v. Van Rensselaer, 1 Johns. 94 (N.Y. 1806) (holding that the defendant could not avoid enforcement of a promissory note on the basis that the plaintiff had violated a French revenue provision requiring French stamp tax first be paid); *see also* Brenda Mallinak, *The Revenue Rule: A Common Law Doctrine for the Twenty-First Century*, 16 DUKE J. COMP. & INT'L L. 79, 79–83 (2006).

221. *See, e.g.*, Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 413–14, 448, 450 n.11 (1964); United States v. Harden, [1963] S.C.R. 366 (Can.); *see also* Gov't of India v. Taylor, [1955] A.C. 491 (H.L.)

scribed as "the first and most fundamental rule of international tax law."[222] While some argue that there have been incursions on the judicial doctrine, the basic judicial presumption reflects the policymaking default against collecting tax for foreign sovereigns.[223]

3. Multilateral Automatic Information Exchange

Unlike cross-border collection assistance, the idea of cross-border tax information exchange has global acceptance, at least upon request. Since 2009, every financial center of any significance, including all of the more than one hundred member countries of the Global Forum on Transparency and Exchange of Information, has endorsed the international standards calling for tax information exchange.[224] The G8, the G20, the OECD, and the United Nations also have endorsed them.[225]

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508 (appeal taken from Eng.); Williams & Humbert Ltd. v. W & H Trade Marks (Jersey) Ltd., [1986] A.C. 368 (H.L.) (appeal taken from Eng.); Peter Buchanan Ltd. v. McVey, [1955] A.C. 516 (Ir. H. Ct. 1950) (surveying application of the revenue rule by U.K. courts), *aff'd*, [1955] A.C. 530 (Ir. S.C. 1951); William S. Dodge, *Antitrust and the Draft Hague Judgments Convention*, 32 LAW & POL'Y INT'L BUS. 363, 373 n.43 (2001) (treating the application of the revenue rule in both common law and civil law countries as a subcategory of a disinclination to enforce foreign public law).

222. Vitaly S. Timokhov, *Enforcing Tax Judgments Across Borders: How Collection Assistance Can Overcome Limitations of the "Revenue Rule"* (*Part 1*), J. INT'L TAX'N, June 2003, at 34, 37; *see also* Vitaly S. Timokhov, *Enforcing Tax Judgments Across Borders: How Collection Assistance Can Overcome Limitations of the "Revenue Rule"* (*Part 2*), 14 J. INT'L TAX'N, Sept. 2003, at 20.

223. *See, e.g.*, Pasquantino v. United States, 544 U.S. 349, 361 (2005) ("[A]t its core, [the revenue rule] prohibited the collection of tax obligations of foreign nations."); *Banco Nacional de Cuba*, 376 U.S. at 448 (White, J., dissenting) ("[C]ourts customarily refuse to enforce the revenue and penal laws of a foreign state, since no country has an obligation to further the governmental interests of a foreign sovereign."), *quoted in Pasquantino*, 544 U.S. at 369–70.

224. GLOBAL FORUM ON TRANSPARENCY & EXCH. OF INFO. FOR TAX PURPOSES, OECD, TAX TRANSPARENCY 2011: REPORT ON PROGRESS 2 (2011) [hereinafter GLOBAL FORUM, TAX TRANSPARENCY], *available at* http://www.oecd.org/tax/transparency/48981620.pdf.

225. *See, e.g.*, Rep. of the Comm. of Experts on Int'l Cooperation in Tax Matters, 2d Sess., Oct. 30–Nov. 3, 2006, U.N. Doc. E/C.18/2006/6/Add.1; ESCOR, Supp. 45 (2006); G7, ECONOMIC COMMUNIQUÉ: MAKING A SUCCESS OF GLOBALIZATION FOR THE BENEFIT OF ALL ¶ 16 (1996), *available at* http://www.mofa.go.jp/policy/economy/summit/1996/eco.html; G8, THE GLENEAGLES COMMUNIQUÉ: AFRICA ¶ 14(i) (2005), *available at* http://www.unglobalcompact.org/docs/about_the_gc/government_support/PostG8_Gleneagles_Communique.pdf; G20, COMMUNIQUÉ: MEETING OF FINANCE MINISTERS AND CENTRAL BANK GOVERNORS, OCTOBER 15–16, 2005 ¶ 2 (2005), *available at* http://www.mof.go.jp/english/international_policy/convention/g20/g20_051016.pdf; OECD, PROMOTING TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES: A BACKGROUND INFORMATION BRIEF 2 (2010); GLOBAL FORUM, TAX TRANSPARENCY, *supra* note 224, at 2; *see also, e.g.*, OECD, COUNTERING INTERNATIONAL TAX EVASION, *supra* note 25; OECD, TAX CO-OPERATION 2010: TOWARDS A LEVEL PLAYING FIELD—ASSESSMENT BY THE GLOBAL FORUM ON TRANSPARENCY AND

These standards are formally cabined to information exchange upon request. Thus, the breach of bank secrecy that these standards require technically only applies where there is a request for foreseeably relevant information about a specific individual. There is nothing in the standards that is conceptually limited to exchange upon request, however, and there is no normative reason for exchange to be limited to information about one individual at a time. Indeed, a newcomer with fresh eyes looking at these internationally-agreed-upon standards would have a difficult time understanding why they did not mandate that all ascribing jurisdictions routinely provide information exchange in those cases where the information is foreseeably relevant (for example, in the case of capital income accruing to a known resident of another state with an income tax).

The recently revised Multilateral Convention provides a multilateral framework under which automatic cross-border tax information exchange could be established among a broad range of sovereign participants.[226] The 2010 protocol made changes that (when integrated with the preexisting convention) make the Multilateral Convention a landmark agreement. The protocol incorporates the internationally accepted standards for the exchange of foreseeably relevant information regardless of bank secrecy and moves in the direction of multilateral routine information exchange by requiring signatories to accept requests from all other signatories with respect to "ascertainable groups or classes of persons."[227] This aspect of the protocol indicates a shift in international norms toward multilateral automatic information exchange.[228] The Multilateral Convention opens the

EXCHANGE OF INFORMATION FOR TAX PURPOSES 9, 15 (2010). A "high-level working panel" convened by the United Nations has previously proposed an International Tax Organization to provide a mechanism for multilateral tax information sharing to curb the scope of tax evasion on investment income earned abroad. U.N. Secretary-General, Letter dated June 25, 2001 from the Secretary-General addressed to the President of the General Assembly, U.N. Doc. A/55/1000 (June 26, 2001), *available at* http://www.un.org/esa/ffd/a55-1000.pdf.

226. *See supra* notes 94–95 and accompanying text.

227. Explanatory Report to the Convention as Amended by the Protocol, Protocol Amending the Convention on Mutual Administrative Assistance in Tax Matters, May 27, 2010, E.T.S. No. 127, ¶ 167, *available at* http://conventions.coe.int/Treaty/EN/Reports/Html/127-Revised.htm.

228. Article III of the 2010 Protocol amends Article 18 of the Multilateral Convention to clarify that a request can be made without the name and address of a specific taxpayer. OECD & COUNCIL OF EUR., MULTILATERAL CONVENTION, *supra* note 93. The Explanatory Report to the Convention goes on explicitly to bless requests made with respect to ascertainable groups or classes of persons. *See* OECD, REVISED EXPLANATORY REPORT TO THE CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS 22 (2010), *available at* http://www.oecd.org/ctp/exchangeofinformation/48091084.pdf; *see also* OECD, 2012 UPDATE, *supra* note 26. The changes to the Commentary to Article 26 of the OECD Model Convention agreed in the summer of 2012 move the Commentary to Article 26 in the direction of the Multilateral Convention's stance with respect to ascertainable group requests.

door to multilateral automatic information exchange through provisions intended to facilitate such exchange, although it requires competent authorities to reach further agreements to bring automatic information exchange into force.[229]

The amended Multilateral Convention can function as a full-fledged vehicle for automatic information exchange among signatories while requiring countries to protect taxpayer information from misuse and respect taxpayer rights. On June 1, 2011, the convention was opened to signature by any country in the world. As of May 2012, thirty-five countries had signed the Protocol to the Multilateral Convention,[230] and every G20 member had endorsed it.[231]

The trend in universally accepted standards for information exchange, the development of a series of emerging automatic information exchange approaches, and the progress made by the Multilateral Convention suggest that acceptance of a widely utilized system that requires financial institutions to function as cross-border tax intermediaries through automatic information reporting may be within reach.

IV. THE PATH TOWARD A MULTILATERAL AUTOMATIC INFORMATION REPORTING SYSTEM

Any new regime for routine cross-border administrative assistance is likely to become an institutionally embedded structure that is susceptible to long periods of stasis. The risk of stasis following the present evolutionary moment in cross-border tax administrative assistance raises the stakes in the present contest between anonymous withholding and automatic information reporting. Since a partial anonymous withholding system can emerge via contracting, while automatic information exchange on offshore accounts by asset management jurisdictions likely requires coercion, partial anonymous withholding is the easier and more likely default. To

229. *See* OECD & COUNCIL OF EUR., MULTILATERAL CONVENTION, *supra* note 93, art. 6.

230. Argentina, Australia, Azerbaijan, Belgium, Brazil, Canada, Costa Rica, Denmark, Finland, France, Georgia, Germany, Greece, Iceland, India, Indonesia, Ireland, Italy, Japan, Korea, Mexico, Moldova, Netherlands, Norway, Poland, Portugal, Russia, Slovenia, South Africa, Spain, Sweden, Turkey, Ukraine, the United Kingdom, and the United States have signed. *See Status of the Convention on Mutual Administrative Assistance in Tax Matters and Amending Protocol, CETS No. 127*, COUNCIL EUR., http://conventions.coe.int/Treaty/Commun/ChercheSig.asp?NT=127&CM=1&DF=&CL=ENG (last visited Oct. 31, 2012).

231. For a list of G20 members, see *supra* note 10. At the November 2011 G20 Summit, all G20 countries also noted, "we will consider exchanging information automatically on a voluntary basis as appropriate and as provided for in the convention." *Cannes Summit Final Declaration—"Building Our Common Future: Renewed Collective Action for the Benefit of All,"* G20, ¶ 35 (Nov. 4, 2011), http://www.g20-g8.com/g8-g20/g20/english/for-the-press/news-releases/cannes-summit-final-declaration.1557.html.

avoid partial anonymous withholding and establish the superior automatic information reporting system, governments will have to make steady progress toward a relatively uniform multilateral approach to information exchange and impose coercive incentives for participation.

As suggested in Part II, the starting point for a multilateral system likely involves reconciling the current EU, OECD, and U.S. approaches. Building such a system requires substantial agreement among participating countries about certain design features. The key dimensions of the EU, OECD, and U.S. systems that would need to be reconciled are routing, identification, reporting, scope, verification, and incentives. A comprehensive blueprint for reconciling the emerging approaches to automatic information reporting along each of these dimensions is beyond the scope of this Article.[232] Joint Statement I implies the need for such reconciliation, however, and the purpose here is to offer some observations as to what could be done to reconcile the emerging approaches and promote a multilateral system. I also suggest some safeguards to ensure that an emerging multilateral automatic information exchange system protects against the misuse of exchanged information.

First, the rules for establishing a multilateral automatic information reporting regime should be bifurcated. Cooperating jurisdictions should impose one set of obligations on financial institutions located in other cooperating jurisdictions and a different, more stringent set of obligations on financial institutions located outside cooperating jurisdictions. Not only are different design decisions appropriate for these two fact patterns, but also, as the discussion below illustrates, creating two separate regimes would likely spur financial institutions to pressure governments to participate since participation could reduce the burden for domestic financial institutions. While bifurcated rules are necessary, alone they are insufficient to encourage the creation of a multilateral automatic information exchange system. Governments also must agree on a set of coercive incentives that push noncooperating jurisdictions to join the system and financial institutions to comply even before their governments do. The following discussion provides some preliminary views on how to apply these two principles in building a multilateral automatic

232. One obvious point is that reciprocal identification and reporting obligations would need to be imposed on financial institutions in all cooperating jurisdictions. This would mean, for example, that U.S. financial institutions would need to exercise the same due diligence to identify accounts of non-U.S. persons and collect precisely the same information on accounts of non-U.S. persons that the United States wishes to receive with respect to U.S. persons with offshore accounts. Although it has finalized the bank deposit interest regulations, 77 Fed. Reg. 23,391, 23,394–95 (Apr. 19, 2012) (to be codified at Treas. Reg. §§ 1.6049-1 to -8), the U.S. Treasury has not yet provided regulatory guidance to this effect as a companion to its efforts under FATCA.

information exchange system by considering certain design questions associated with routing, identification, reporting, verification, and incentives in a multilateral system.

A. Routing

Routing issues are important because they represent the most basic structural inconsistency between today's emerging automatic information exchange approaches. Routing also deserves attention because routing raises questions about sovereign access to and authority over information. Under the OECD's TRACE approach, financial institutions report information regarding specific items of income received by a taxpayer to the government of the country that is the source of that income. That government may then decide to exchange the information with the taxpayer's country of residence if it so desires and if appropriate information exchange arrangements are in place. Under the EU approach, in contrast, financial institutions report on specific items of income received by an EU resident to the government where the financial institution managing the assets resides. EU governments then exchange information related to each other's resident taxpayers through arrangements of reciprocity. Finally, under FATCA, foreign financial institutions report comprehensively on assets and certain measures of income of U.S. persons held and/or earned through accounts at those institutions.[233] As legislated, they report directly to the government of the jurisdiction where the taxpayer resides (the United States).

The EUSD's routing system is superior for jurisdictions that are cooperating with one another. It ensures that financial institutions in cooperative jurisdictions need only send information to one government, under whose law they already operate, thereby avoiding the specter of thousands of financial institutions attempting to comply with different reporting obligations to dozens of governments. Reporting by financial institutions to the government of the jurisdiction in which they reside, followed by government-to-government exchange, also conforms most closely to current global understandings regarding first-instance sovereign access to banking information. The government of the asset management country presumptively can already access the relevant information under current law and regulations.[234] The EUSD system thus avoids the conflict-of-law issues associated with

233. *See* I.R.S. Notice 2011-34, 2011-1 C.B. 765, *available at* http://www.irs.gov/pub/irs-drop/n-11-34.pdf.

234. Indeed, government access to such information for tax information exchange purposes is required pursuant to the internationally-agreed-upon standards for tax information exchange upon request. *See*

financial institutions reporting directly to foreign sovereigns. It also avoids concerns about power shifts associated with adopting a multilateral information exchange regime that alters the distribution of information with respect to nonresident accounts.[235] Likely for these reasons, Joint Statement I contemplates adopting the EU routing system for cooperating countries.[236]

FATCA's statutory routing system for reporting directly from financial institutions to foreign sovereigns violates local financial privacy and data protection law in many jurisdictions.[237] It is therefore inappropriate for countries that are cooperating with one another. However, requiring information reporting directly from would-be-compliant financial institutions located in noncooperating jurisdictions pressures those jurisdictions to cooperate. It also provides a mechanism for financial institutions that wish to cooperate with new global norms to do so regardless of their government's policy decisions. Thus, FATCA's statutory routing system provides a useful tool for eliciting compliance from cooperative financial institutions in jurisdictions that resist cooperating with a multilateral information reporting regime and for pressuring those governments to cooperate.

The ICG system's routing model, on the other hand, is inapt for a multilateral regime focused on residence taxation. It sends information around the horn from account holders' financial institutions to source countries, and from source countries on to residence countries. In the process it disaggregates the information relevant to residence countries—a complete picture of their residents' offshore ac-

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OECD, TERMS OF REFERENCE: TO MONITOR AND REVIEW PROGRESS TOWARDS TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES 6–7 (2010) [hereinafter OECD, TERMS OF REFERENCE], *available at* http://www.oecd.org/dataoecd/37/42/44824681.pdf.

235. To illustrate the point, imagine that to comply with FATCA, the IRS issued administrative guidance requiring financial institutions to provide the IRS information on the accounts of all nonresident account holders (not just U.S. accounts). Imagine the IRS then promised to forward information it received about each country's residents to tax administrations around the world. In principle this arrangement could create a multilateral system. For certain sovereigns, such a system might even be attractive, especially if it would give them valuable information they did not believe they could obtain by other means. If such a system applied to nonresident accounts of all countries, however, the United States would have access to and control of all information about all nonresident accounts around the world. Many sovereigns would oppose such a system. In contrast, a globalized version of the EU routing system would send information about nonresidents through the country where asset management occurs. The asset management country's government presumptively already could access that information today. For that reason alone, this system seems both the fairest and least disruptive. Further, the EU routing system forwards only information about a country's residents to that country's government. In this way, it does not raise the same issues about informational power raised by the earlier hypothetical.

236. Joint Statement I, *supra* note 4.

237. *See supra* note 110 and accompanying text; *see also* Joint Statement I, *supra* note 4.

counts—and excludes part of that picture, namely information related to payments not eligible for reduced withholding.

B. Identifying Taxpayers and Their Countries of Residence

The taxpayer identification rules for participating financial institutions in the ICG system require those institutions to check a customer's self-declared identity and residence against all other information the institution already has in its possession.[238] The ICG system's principle (using information already in a financial institution's possession) is a more accurate starting point for a multilateral system than the EUSD's current rule (which treats taxpayers as residing wherever they resided at the time their most recent passport was issued).[239] FATCA's customer identification rules are just one way of fleshing out the details of the OECD's principle, and those identification rules may prove a useful starting point for discussions of how to implement a multilateral regime.[240] However, FATCA's rules for customer identification (as described in proposed Treasury regulations released on February 8, 2012) are highly prescriptive.[241]

In many cases involving financial institutions in cooperating jurisdictions, highly prescriptive rules may be costly to implement without providing any benefit

238. OECD, REPORT BY THE PILOT GROUP ON IMPROVING PROCEDURES FOR TAX RELIEF FOR CROSS-BORDER INVESTORS: POSSIBLE IMPROVEMENTS TO PROCEDURES FOR TAX RELIEF FOR CROSS-BORDER INVESTORS: IMPLEMENTATION PACKAGE 9–10 (2010), *available at* http://www.oecd.org/dataoecd/20/36/44556378.pdf.

239. Discussion of proposals to, inter alia, strengthen the identification rules of the EUSD and ensure that it covers all payments that are equivalent to interest has been ongoing since 2008, but the European Union has not yet reached unanimity on these matters. *See Proposal for a Council Directive Amending Directive 2003/48/EC on Taxation of Savings Income in the Form of Interest Payments*, at 15–16, COM (2008) 727 final (Nov. 13, 2008), *available at* http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)727_en.pdf.

240. A broadly multilateral system would be unlikely to identify nonresident citizens. The United States is almost alone globally in taxing bona fide nonresident citizens as if they were residents. Indeed, bona fide nonresident U.S. citizens working outside the United States have in some instances encountered serious difficulties banking in the countries in which they reside as a result of FATCA. Such persons rightfully note that their bank accounts in the country where they reside are not offshore accounts and that it is inappropriate for regulatory rules to make it difficult for them to maintain residence country financial accounts. For one account, see Letter From Marylouise Serrato, Exec. Dir. & Jackie Bugnion, Dir., Am. Citizens Abroad, to Timothy F. Geithner, Sec'y, U.S. Dep't of the Treasury, Manal Corwin, Deputy Assistant Sec'y, U.S. Dep't of the Treasury, Douglas Shulman, Comm'r, IRS & Steve Musher, Assoc. Chief Counsel (Int'l), IRS (Aug. 31, 2011), *available at* http://www.deloitte.com/assets/DcomUnitedStates/Local%20Assets/Documents/Tax/us_tax_ACA_2011_18533_1_090811.pdf.

241. Regulations Relating to Information Reporting by Foreign Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities; Proposed Rule, 77 Fed. Reg. 9021 (Feb. 15, 2012) (to be codified at Treas. Reg. §§ 1.1471–1.1474).

to governments beyond those available through a principles-based system. Rules that allow financial institutions to exercise greater judgment could substantially reduce costs. Governments should not be concerned about less prescriptive rules for financial institutions in cooperating jurisdictions if cooperating jurisdictions (1) develop shared principles for due diligence to determine beneficial ownership of accounts, (2) impose legal sanctions on domestic financial institutions that fail to adequately discharge a legal duty to identify nonresident beneficial owners of accounts, and (3) commit to use credible domestic regulatory mechanisms to enforce these (potentially risk-based) rules (together "Principles-Based Rules"). A more prescriptive system, however, with tougher customer identification rules, is appropriate where domestic regulatory oversight is absent and therefore does not provide an additional incentive for good-faith compliance. The U.S. experience with UBS and other private banks might suggest some caution regarding reliance on know-your-customer information and subjective reason-to-know standards alone for financial institutions not located in participating countries. For the United States, bifurcation of customer identification rules would suggest tightening prescriptive due-diligence rules imposed under FATCA regulations while agreeing to more principles-based and less onerous rules as part of the Joint Statement I process with cooperating governments. Indeed the model intergovernmental agreement effectively permits financial institutions in Joint Statement I countries to use less onerous, more principles-based techniques developed for anti-money-laundering purposes to identify account holders and the country of residence of their controlling persons.[242] However, the model intergovernmental agreement is not multilateral. It merely provides the basis for a series of bilateral agreements with the United States. It therefore does not take the next step of prescribing standards cooperating jurisdictions must meet to qualify for Principles-Based Rules.

C. Reporting

In proposed regulations, the U.S. Treasury replaced FATCA's statutory rule for what information should be reported by financial institutions with a rule requiring reporting of dividends, interest, and other income, as well as gross proceeds, determined under the same principles that a financial institution uses to report information in its jurisdiction of residence.[243] The U.S. Treasury's decision with regard to income reporting conforms the basis for determining amount and char-

242. MODEL INTERGOVERNMENTAL AGREEMENT, *supra* note 4.
243. 77 Fed. Reg. at 9032 (to be codified at Treas. Reg. § 1.1471-4(d)(4)).

acter of income for FATCA reporting purposes to the European Union's Directive on Administrative Cooperation in the Field of Taxation.[244] If the FATCA regulations are viewed as a predecessor to a multilateral system, however, FATCA reporting guidelines also may represent the United States's initial view of what types of information should be reported in a multilateral system with respect to offshore accounts. As described in Part III, account balance reporting is likely important to addressing evasion with respect to untaxed principal.[245]

D. Verifying Financial Institution Compliance

If financial institutions must report the same information for both resident and nonresident account holders to the tax administration of the country in which they are located, then it may be reasonable to rely on participating countries' self-interest in their own tax base to ensure appropriate implementation of the taxpayer identification and information reporting rules. Further verification arguably becomes unnecessary.[246] The European Union sensibly relies on this principle under the presumption that institutions whose compliance with the EUSD would need to be verified are already subject to domestic regulatory regimes that make similar demands. The concept would be similarly compelling in the context of a multilateral system if countries have agreed to Principles-Based Rules.

For compliant institutions in noncooperative jurisdictions, however, some independent verification system is needed to ensure compliance. Of course, noncooperative jurisdictions will not let the tax administration of a complying sovereign into their country to verify financial institution compliance. Thus, relying on inde-

244. *See supra* note 85 and accompanying text.

245. Note, however, that the Joint Statement and model intergovernmental agreements imply that FATCA Partner Countries will implement legislation to collect and report the information required under FATCA. Joint Statement I, *supra* note 4. Yet, account balance reporting may not be required with respect to domestic accounts under most countries' existing law, even among countries that rely on information reporting systems to collect tax on capital income. Thus, changes in domestic law or regulations to allow for account balance reporting for nonresident accounts will present a significant challenge for a multilateral system that would be significantly eased by agreed-upon international standards in this regard.

246. A multilateral regime could also incorporate an explicit requirement that the enforcement mechanisms that apply to ensure domestic reporting also must apply with respect to nonresident accounts. Note that the model intergovernmental agreement issued by the United States and the G-5 includes an analogous provision suggesting that if one competent authority believes a financial institution in the other jurisdiction is engaged in significant noncompliance, it may notify its counterpart competent authority, and that competent authority will apply its domestic law (including penalties imposed domestically) to address the described noncompliance. MODEL INTERGOVERNMENTAL AGREEMENT, *supra* note 4, art. 5(2)(a).

pendent accounting firms to verify compliance in noncooperative jurisdictions would seem the most promising approach in the context of a cross-border automatic information reporting system that has achieved broad multilateral acceptance, such that audits are limited to a small number of jurisdictions.[247]

E. Encouraging Compliance

As described in Part III.A, ensuring compliance with a new global regime is likely to require some level of coercion, or what the G20 calls "defensive measures."[248] FATCA's 30 percent withholding tax is best understood as such a defensive measure. Similarly, FATCA's passthru payment rules are, at the highest level, best understood as an attempt to expand the reach of this defensive measure. Here, FATCA differs from the OECD approach, which lacks coercive measures to ensure broad compliance. It also differs from the EU approach, which can mandate government participation within the European Union but currently lacks mechanisms to broaden the system beyond the member states and their dependencies. A multilateral regime that realistically intends to ensure global compliance should require all participating jurisdictions to impose some defensive measure. These cooperating jurisdictions need not impose 30 percent withholding, but similar coercive measures are a necessary component of a multilateral automatic information reporting system. Otherwise, noncooperative jurisdictions and institutions benefit from defecting from the emerging regime because they can become repositories of choice for tax evader assets without paying a significant price for making that business decision. In recognition of this reality, both Joint Statement I and the model intergovernmental agreement that followed Joint Statement I commit the parties to "develop a practical and effective alternative approach to achieve the policy objectives of passthru payment withholding."[249]

Coercive measures are necessary to create a multilateral automatic information exchange system, but they are also incompatible with the existence of bilateral anonymous withholding arrangements. Indeed, if one or more major financial centers were prepared to impose defensive measures, but were willing to suspend those measures if they received anonymous withholding from another jurisdiction

247. Cost considerations mitigate strongly against independent accounting firm verification until broad multilateral acceptance is achieved. This presents just one example of how verification rules under FATCA and verification rules for a multilateral system should be different.

248. *See supra* note 10.

249. Joint Statement I, *supra* note 4; MODEL INTERGOVERNMENTAL AGREEMENT, *supra* note 4, art. 6(2).

on a bilateral basis, it would undercut the coercive force of coordinated defensive measures. The lost leverage affects not only the countries receiving anonymous withholding but also all other countries participating in the multilateral automatic information exchange system. The negative consequences thus redound largely to less wealthy, less powerful economies. A jurisdiction can defect from the automatic information exchange system, provide anonymous withholding to a few powerful financial centers, and continue promoting anonymity without withholding for residents of all other jurisdictions. For this reason, the Swiss anonymous withholding agreements are difficult to reconcile with a multilateral automatic information exchange system.

A related concern regarding lost leverage for a multilateral automatic information exchange system arises under the bilateral framework proposed by the United States and Switzerland in Joint Statement II. However, the impact of the Joint Statement II framework on third countries that desire automatic information exchange is mixed. Unlike the Swiss anonymous withholding agreements, Joint Statement II forces Swiss financial institutions to build the information reporting architecture required for FATCA compliance and forces Swiss law to accommodate such reporting as the price of avoiding FATCA withholding. At the same time, Joint Statement II does suspend defensive measures in return for concessions to the United States alone.

As with FATCA, coercive measures adopted to promote a multilateral system should function on the principle that a financial institution in a noncooperating jurisdiction will not be punished if it reports information directly and circumvents the tax administration of the country in which the institution is located. Such measures put pressure on financial institutions to comply regardless of local law and on governments to change local law to allow financial institutions to comply.

F. Addressing Concerns Regarding Potential Misuse of Information

One of the critical principles under existing international standards for information exchange upon request is that the residence state receiving information must ensure that exchanged information is only used for legitimate tax administration purposes.[250] Countries that do not abide by this standard are not entitled to

250. The current globally agreed rules developed over a long period in response to, inter alia, the concern that information exchange could be used to facilitate improper efforts to attach or confiscate assets by abusive or illegitimate regimes. Such concerns are important in an information exchange upon request system. Indeed, these concerns may be more pronounced in information exchange upon request than in automatic information exchange because unlike automatic information exchange, informa-

information exchange upon request under current international standards. The Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum), a peer review body that includes over one hundred member jurisdictions, is mandated to assess jurisdictions to ensure that they all adhere to this high standard, and those assessments are presently ongoing.[251] In an automatic information exchange system, the same high standards proscribing misuse of information would presumably apply. In fact, the current members of the Multilateral Convention have clarified that they will not admit to the convention new countries that do not have proper safeguards in place to ensure that exchanged information will not be misused.[252] A multilateral automatic information exchange system should both enforce the existing Multilateral Convention's upfront requirement that governments have laws in place consistent with international standards to prevent the misuse of exchanged information, and provide for monitoring systems and credible sanctions (including denial of information exchange or removal from the multilateral system) as part of the establishment of any multilateral automatic information exchange system.[253] Taking these two steps would both protect the

tion exchange upon request asks the requested jurisdiction to use its investigatory powers on behalf of the requesting state. The protections for taxpayer rights and exchanged information built into the current international standards are focused on ensuring that exchanged information is only used for legitimate tax administration purposes. *See* OECD MODEL CONVENTION, *supra* note 25, art. 26(2); OECD, AGREEMENT ON EXCHANGE OF INFORMATION ON TAX MATTERS, art. 8 (2002), *available at* http://www.oecd.org/dataoecd/15/43/2082215.pdf; OECD, TERMS OF REFERENCE, *supra* note 234, at 8–9 (describing the globally agreed standard against which all 102 members of the Global Forum are presently being assessed, including terms of reference C.3. and C.4. regarding protecting against misuse of information and ensuring safeguards for taxpayers); *see also supra* note 121.

251. *See* GLOBAL FORUM ON TRANSPARENCY & EXCH. OF INFO. FOR TAX PURPOSES, OECD, PROGRESS REPORT TO THE G20 (2012), *available at* http://www.oecd.org/ctp/exchangeofinformation/G20_Progress_Report_June_2012.pdf.

252. *See* OECD, CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS: PROCESS TO BECOME A PARTY TO THE AMENDED CONVENTION (n.d.), *available at* http://www.oecd.org/ctp/exchangeofinformation/Process_to_Become_a_Party_to_the_Amended_Convention.pdf.

253. The appropriate monitoring system could involve an expansion of the current Global Forum assessment process, with a special in-depth ongoing monitoring system on the question of whether automatically exchanged information is used by a government that receives information in ways consistent with the existing international standards that protect taxpayers' rights, and proscribe use of exchanged information for purposes other than legitimate tax administration purposes. Indeed, the beginnings of such a process will commence late in 2012. At that point, the Global Forum on Transparency and Exchange of Information Phase II peer reviews will begin to consider whether, in practice, jurisdictions conform to the rules limiting the use of information exchanged upon request to legitimate tax administration purposes. *See* GLOBAL FORUM ON TRANSPARENCY & EXCH. OF INFO. FOR TAX PURPOSES, OECD, REVISED METHODOLOGY FOR PEER REVIEWS AND NON-MEMBER REVIEWS (2011), *available at* http://www.oecd.org/ctp/44824721.pdf.

integrity of an automatic information exchange system and very substantially encourage compliance with global standards for protecting taxpayer information from misuse.

CONCLUSION

In just a few short years, the world has gone from assuming that financial institutions generally do not support residence country cross-border taxation to arguing about how they should act as tax agents for residence countries. This represents a remarkable shift in international norms. Focusing exclusively on the contest between the information reporting and anonymous withholding models for a new regime inappropriately obscures the growing consensus. The competing initiatives for cross-border tax administrative assistance put forth by the United States, the European Union, the OECD, and Switzerland, and the response of financial institutions to those proposals, all highlight the development of a new international regime in which financial institutions will be cross-border tax intermediaries.

Nevertheless, a great deal is at stake in the choices currently being made between partial anonymous withholding and a broadly available automatic information reporting regime for cross-border administrative assistance. The choice between the two approaches is real even if the consequences of choosing between the available alternatives seem somewhat distant for most jurisdictions. Path-dependence and the tendency for institutional structures in this area to become embedded suggest that suboptimal decisions made by a small number of powerful actors may dictate outcomes for both those actors and the rest of the world for a prolonged period.

Anonymous withholding is not likely to be made available to most countries. In contrast, information reporting provides a workable architecture for an emerging regime of financial institutions acting as cross-border tax intermediaries in which most countries may reasonably aspire to participate. Even though some jurisdictions can be counted on to resist a broadly available automatic information reporting system, if these countries become outliers, international regimes will evolve around them, and eventually pressure may make noncompliance with the regime unsustainable.

Emerging-economy governments and other stakeholders, including civil society, have many reasons beyond sheer revenue to weigh in on the choices being made by the major actors in this evolutionary moment. Information reporting can help sustain tax morale in a financially integrated world. Information reporting may also allow capital income taxation to play a role in building a liberal democracy

that is accepted as legitimate by its people and to encourage taxpayers to engage with the polity and demand government accountability. Anonymous withholding, in contrast, institutionalizes differentiated treatment for the most sophisticated taxpayers from the rest of society. Further, anonymous withholding systems leave open the possibility that asset management jurisdictions may one day decline to implement a country's changes in its own tax regime, thereby undermining domestic authority as well as policy flexibility, especially for less powerful states.

Together, the emerging models presented by the European Union, the OECD, and the United States hold within them the seeds of a workable automatic information reporting regime. Multilateral vehicles also already exist to work toward a multilateral system. For instance, the Coordinating Body of the Multilateral Convention has the authority to study methods and procedures to increase international cooperation in tax matters, and the Multilateral Convention provides the legal authority for multilateral automatic information exchange. International tax policymakers should seize the present evolutionary moment and push for the emerging automatic information exchange approaches to be reconciled in a manner that can support the tax administration needs of developed and emerging economies alike.