withholding tax is imposed by Swiss financial institutions, the investor's tax obligation to the Partner Country will be fulfilled.[119] 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.[120]

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.[121] 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.[122] This one-time charge is intended as a rough proxy to

---

U.K.-Switz. Protocol Amendment, *supra* note 4, at art. 8 (note that for interest income governed by art. 19(3), the Protocol has changed the rate from 48 percent to 50 percent). 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), *available at* http://www.efd.admin.ch/dokumentation/medieninformationen/00467/index.html?lang=en&msg-id=40533. 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), *available at* http://www.news.admin.ch/message/index.html?lang=en&msg-id=44130.

119. *See* U.K.-Switz. Cooperation Agreement, *supra* note 13, at art. 9(7),-9(12),-9(13),-19(5); Ger.-Switz. Cooperation Agreement, *supra* note 13, at art. 7(6),-18(4); Austria-Switz. Cooperation Agreement, *supra* note 4, at art. 7(6),-17(3).

120. *Id.*

121. U.K.-Switz. Cooperation Agreement, *supra* note 13, at art. 9; Ger.-Switz. Cooperation Agreement, *supra* note 13, at art. 7; Austria-Switz. Cooperation Agreement, *supra* note 4, at art. 7.

122. 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. Press Release, Swiss Fed. Dep't of Fin., Switzerland and Germany Initial Tax Agreement, *supra* note 118; U.K.-Switz. Cooperation Agreement, *supra* note 13, at art. 9; Ger.-Switz. Cooperation

Draft: Do Not Cite

compensate for past tax evasion. A one-time charge to address the past should be separated conceptually from the issues associated with an anonymous withholding system for taxing future dividends, interest, and capital gains.[123]

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.[124] 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.[125]

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.[126] Switzerland will also tell the Partner Country how many of its residents moved funds out of Switzerland to those

---

Agreement, *supra* note 13, at art. 7; U.K.-Switz. Protocol Letters, *supra* note 13; Austria-Switz. Cooperation Agreement, *supra* note 4, at art. 7.

123. 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 13, at art. 10; Ger.-Switz. Cooperation Agreement, *supra* note 13, at art. 9; Austria-Switz. Cooperation Agreement, *supra* note 4, at 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.

124. *See* U.K.-Switz. Cooperation Agreement, *supra* note 13, at art. 7(1); Ger.-Switz. Cooperation Agreement, *supra* note 13, at art. 5(1); Austria-Switz. Cooperation Agreement, *supra* note 4, at art. 5(1).

125. *See* U.K.-Switz. Cooperation Agreement, *supra* note 13, at art. 17(2); Ger.-Switz. Cooperation Agreement, *supra* note 13, at art. 15(2). The agreement with Austria does not include an upfront payment.

126. *See* U.K.-Switz. Cooperation Agreement, *supra* note 13, at art. 18; Ger.-Switz. Cooperation Agreement, *supra* note 13, at art. 16; Austria-Switz. Cooperation Agreement, *supra* note 4, at art. 15.

Draft: Do Not Cite

various ten jurisdictions, but will not identify those people.[127] 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 automatic basis."[128] 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.[129] For this reason, the Swiss press almost universally described the agreements as a major coup in Switzerland's rearguard effort to defend bank secrecy.[130]

D. A New International Regime?

It is easy to see the OECD, EU, U.S., and Swiss 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

---

127. *See* U.K.-Switz. Cooperation Agreement, *supra* note 13, at art. 18; Ger.-Switz. Cooperation Agreement, *supra* note 13, at art. 16; Austria-Switz. Cooperation Agreement, *supra* note 4, at art. 15.

128. *See* U.K.-Switz. Cooperation Agreement, *supra* note 13, at art. at 1; Ger.-Switz. Cooperation Agreement, *supra* note 13, at art. 1; Austria-Switz. Cooperation Agreement, *supra* note 4, at art. 1.

129. *See, e.g.*, Press Release, Swiss Federal Department of Finance, Switzerland and the UK Initial Tax Agreement, *available at* http://www.sif.admin.ch/00488/index.html?lang=en&msg-id=40731.

130. *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 (last visited May 29, 2012).

Draft: Do Not Cite

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 United States, the European Union, the OECD, and Switzerland 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 tax intermediaries cross-border 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 commerce. The submissions consistently accept, either explicitly or implicitly, that the time has come for financial intermediaries to be tax intermediaries cross-border.[131] Financial institutions are embracing a multilateral approach, if only to best manage their compliance costs as tax intermediaries cross-border.

Thus, the British Bankers Association (BBA), although scathingly critical of FATCA in a series of comments letters to the U.S. Treasury, noted that although FATCA is intended to combat U.S. tax evasion, the problem is a global one that can only be solved with participation

---

131. 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 the motives of any given institution) do not change the basic decision to endorse a multilateral regime. *See, e.g.*, Alternative Investment Management Association, *Foreign Account Tax Compliance ('FATCA')*, Letter to Steven Musher, Assoc. Chief Counsel, Int'l, IRS, and Manal Corwin, Int'l Tax Counsel, U.S. Dep't of the Treasury (June 29, 2010), *available at* http://www.bsmlegal.com/PDFs/AIMAsubmissiontoUSTreasuryandIRSreFATCA29June.pdf. *See also infra* notes 132–133 and accompanying text.

Draft: Do Not Cite

by financial institutions. In a moment of shocking clarity regarding policy by the standard of financial industry submissions to tax regulatory processes, the BBA suggested that "[i]n the longer term, we urge the U.S. and other nations to work toward 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."[132] 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 about the importance of developing a coordinated multilateral approach for financial institutions to serve as cross-border tax intermediaries.[133]

---

132. 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 ('THE NOTICE') (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 ('THE NOTICE') (June 7, 2011), *available at* http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_British_Bankers_Ass_06072011_061611.pdf.

133. *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 Internal Revenue Serv., Re: 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 U.S. 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., Re: Comments of the Dutch Banking

Draft: Do Not Cite

Financial sector commentary regarding the OECD's TRACE project highlights the same convergence around the idea of financial institutions as tax intermediaries cross-border. Consider the submission of the Capital Markets Tax Committee of Asia (CMTCA) to the OECD's work. CMTCA is a financial services industry body consisting of 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."[134] 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.[135] 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."[136] 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 intermediation by financial institutions—has at least resigned itself to this new regime.

Association on the Foreign Account Tax Compliance Act, as well as Notice 2010-60 and Notice 2011-34 (June 9, 2011), *available at* http://www.deloitte.com/view/en_US/us/Services/tax/40f3486234d42310VgnVCM2000001b56f00aRCRD.htm ("[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., Re: 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).

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

135. *Id.*

136. *Id.*

Draft: Do Not Cite

Finally, and as described earlier, Swiss financial institutions have not only 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, "[t]he 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."[137]

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),[138] and the management location for well more than 80 percent of global financial assets.[139] 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 tax agents for governments cross-border. 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 tax intermediaries cross-border—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

---

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

138. U.S. Dep't of State, *What is the OECD?*, U.S. MISSION TO THE OECD, http://usoecd.usmission.gov/mission/overview.html (last visited May 30, 2012).

139. Eighty-two percent of financial assets globally (managed both domestically and offshore) are managed from the United States, the United Kingdom, Switzerland, France, Germany, or Japan. 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.

Draft: Do Not Cite

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.

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 tax agents for governments cross-border. Neither system represents the most comprehensive solution to address offshore accounts, which would involve nonanonymous cross-border withholding in combination with information reporting.[140] However, between the two models presently under consideration internationally, 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.

---

140. *Cf.* MICHAEL KEEN AND JENNY E. LIGTHART, INFORMATION SHARING AND INTERNATIONAL TAXATION, TILBERG UNIV. DISCUSSION PAPER NO. 2004-117, at 3 (Nov. 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).

Draft: Do Not Cite

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, only serve 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, the suboptimal result represented by anonymous withholding for a limited number of countries may become a stable equilibrium. This dynamic makes 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. 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. Untaxed principal is a significant concern for tax administrators. While scholarly discussions of tax evasion often focus on tax revenues lost because of untaxed investment income,[141] 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.[142] For instance, the hearings of the Permanent Subcommittee on Investigations (PSI), which served as a catalyst for recent U.S. efforts to crack down on offshore tax evasion, focused intently on exactly this kind of

---

141. *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).

142. Discussions between author and current and former government officials from Australia, Denmark, France, Germany, India, and the United States.

Draft: Do Not Cite

tax evasion.[143] U.S. Department of Justice prosecutions have similarly reflected the concern that taxpayers are evading tax by fraudulently shifting domestic taxable income offshore.[144] These same concerns are shared by tax administrators outside the United States, as demonstrated by their discussions in global forums.[145]

Understanding the prevalence of concerns regarding the fraudulent use of offshore structures to evade domestic business income tax is imperative to a cogent evaluation of anonymous withholding. Even if an anonymous withholding system were adopted by all countries, it would not address or deter the use of offshore structures and specious transactions to evade domestic

---

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

144. *See, e.g.*, Barton Massey, *Convicted Bank Chairman is Key to Dozens of New Tax Haven Cases*, 19 TAX NOTES INT'L 959, 959–60 (Sept. 13, 1999); GAO, QUALIFIED INTERMEDIARY PROGRAM, *supra* note 64, at 23 (describing 2007 indictment of adult entertainment mogul for using offshore companies that he owned to overstate business and personal expenses, while concealing his ownership of those companies); 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-DN (D. Utah Jan. 18, 2008). *See also Tax Haven Banks and U.S. Tax Compliance*, *supra* note 68, at 17–18.

145. *See* OECD, SEOUL DECLARATION, THIRD MEETING OF THE OECD FORUM ON TAX ADMINISTRATION (Sept. 15, 2006) (thirty-five tax commissioners and deputy tax commissioners from OECD and non-OECD economies express concern regarding outright fraud to conceal income and assets using offshore business entities). *See also, e.g.*, FIN. COMM'N, NAT. ASSEMBLY OF FR., INFORMATION REPORT NO. 1902, at 147–56 (Sept. 10, 2009), *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, *available at* http://www.bundesfinanzministerium.de/nn_4146/DE/BMF__Startseite/Aktuelles/Aktuelle__Gesetze/Gesetze__Verordnungen/040__SteuerhinterziehunsbekG__anl,templateId=raw,property=publicationFile.pdf (increasing reporting requirements for business transactions with entities in jurisdictions lacking tax transparency).

Draft: Do Not Cite

taxation. Withholding in any anonymous withholding system only applies 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 domestic business income tax through offshore accounts on a forward-going basis. Furthermore, anonymous withholding exists to limit exchange of information, 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 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,[146] 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 tax evasion (run-of-the-mill tax evasion is not a crime under Swiss law). One difficulty with this compromise was that it forced the two states to define the term "tax fraud" for purposes of the treaty.[147] 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. The

---

146. United States Model Income Tax Convention, *supra* note 61, at art. 26(1).

147. 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 treaty 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 Amending 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, *available at* http://www.irs.gov/pub/irs-trty/swiss.pdf.

Draft: Do Not Cite

agreements focused heavily on issues likely to arise through the fraudulent use of offshore structures to evade taxes on domestic business income.[148]

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. Each example involved evasion of tax on domestic-source income through the use of offshore accounts. One representative example involved an individual that operates a domestic business, forms a third-country corporation of which he is the disguised owner, and maintains an offshore bank account in the corporate name. 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 offshore bank account of the corporation. 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

---

148. 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." Protocol Amending 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. 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 [2003 U.S.-Switz. Agreement].

Draft: Do Not Cite

withholding in the early debates over the EUSD at the turn of the twenty-first century. The United Kingdom 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."[149]

2. Administrability

Another argument made 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 of the same operational challenges. A multilateral anonymous withholding system along the lines of the Swiss model must (1) determine how to identify taxpayers' country 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 identified 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

---

149. *See* HM TREASURY, UNITED KINGDOM, EXCHANGE OF INFORMATION AND THE DRAFT DIRECTIVE ON TAXATION OF SAVINGS ¶ 3 (Feb. 2000), http://archive.treasury.gov.uk/docs/2000/eoi.html (last visited Feb. 2, 2012) [hereinafter HM TREASURY, EXCHANGE OF INFORMATION]. 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 because of the United Kingdom's growing role as a major offshore asset manager.

Draft: Do Not Cite

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.[150] 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 type of income and country of residence of the customer, providing automatic information reporting instead of withholding requires adding only two pieces to the system: TINs and information technology that allows 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.[151] Solving the latter problem involves significant but feasible investment in IT development and allowing time to implement the new technology. That much has already been demonstrated by the successful operation of the EUSD,[152] as well as the work of expert groups at the OECD.[153]

---

150. 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.

151. *See* OECD, RECOMMENDATION OF THE COUNCIL ON THE USE OF TAX IDENTIFICATION NUMBERS IN AN INTERNATIONAL CONTEXT, (Mar. 13, 1997), *available at* http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=C(97)29/FINAL&docLanguage=En; *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 TO IMPROVE TAX COMPLIANCE AND TO IMPLEMENT FATCA, *supra* note 4, at Art. 6(3) (reciprocal commitment to collect TINs—agreed to approximately six months after a version of this Article, entitled "Beyond FATCA: An Evolutionary Moment for the International Tax System" first appeared on the Social Science Research Network).

152. *See* COMM'N OF THE EUR. CMTYS., REPORT FROM THE COMMISSION TO THE COUNCIL IN ACCORDANCE WITH ARTICLE 18 OF COUNCIL DIRECTIVE 2003/48/EC ON TAXATION OF

Draft: Do Not Cite

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.[154] 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, common to automatic information exchange and anonymous withholding, of (1) identifying taxpayers and their country of residence, (2) collecting information about interest, dividends, capital gains, and other income earned by nonresident taxpayers, and (3) ensuring financial institution compliance.[155]

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 any entity, or on passthru payments, as does FATCA. These arguments are not on point. The withholding imposed by FATCA on

---

SAVINGS INCOME IN THE FORM OF INTEREST PAYMENTS, 2 (Sept. 15, 2008) (emphasizing the need for taxpayer identification numbers (TINs), and with that caveat suggesting exchange is workable through preexisting channels of communication established among EU member states).

153. *See, e.g.*, Spencer, *supra* note 151.

154. SBA ANNUAL REPORT 2009/2010, *supra* note 137, at 17. *But see* Swiss Banking Association, *FATCA Notice 2011: Submission of the Swiss Bankers Association*, Letter to Manal Corwin, Deputy Assistant Secretary Tax Policy (Int'l), U.S. Dep't of the Treasury, Michael Danilack, and Steve Musher, IRS (June 10, 2011), *available at* http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_SBA_061011_NOCOPYRIGHTNEEDED_062311.pdf (last visited Dec. 22, 2011) (complaining about the excessive cost of FATCA account identification, due diligence, and verification procedures as proposed in Notice 2010-60 and Notice 2011-34).

155. It is of course possible that the estimated costs of the Swiss system 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.

Draft: Do Not Cite

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 with only 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.[156]

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 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 benefits only the United States. If such costs were imposed to ensure that automatic information reporting was 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. 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

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

Draft: Do Not Cite

also mediate more regularly between many private citizens and government than any single other 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.[157] 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.[158]

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 in order 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 suggests that tax morale is affected by factors such as citizens' perceptions of other citizens' compliance, and by perceptions of the trustworthiness and competence of the government.[159] This research is consistent with broader empirical research suggesting that

---

157. *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).

158. *See* Bird & Zolt, *supra* note 19, at 1631 ("A country's tax system is thus both an important and a highly visible symbol of its fundamental political and philosophical choices.").

159. 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

Draft: Do Not Cite

individuals' willingness to contribute to public goods depends on whether they trust others to do the same.[160] 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.[161] In contrast, cross-border anonymous withholding provides opacity that prevents governments from receiving the data that would suggest that tax is being collected equitably. It singles 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.[162] 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 tends to fall.[163] In countries like

---

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.").

160. *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' perception that they are not being taken advantage of. *See* Lederman, *supra* note 159, at 1477; *see also* Eric Posner, *Law and Social Norms: The Case of Tax Compliance*, 86 VA. L. REV. 1781, 1784–85 (2000).

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

162. *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 (2009).

163. 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)

Draft: Do Not Cite

Greece, Italy, or the Philippines, weak tax administrations lacking vigorous enforcement programs have contributed to tax evasion carrying very little moral opprobrium.

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 late 1990s so-called coexistence model for the EUSD, 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."[164]

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 citizens in the face of the taxing authority.[165] 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.[166] In contrast to anonymous withholding, information reporting, like identified withholding, allows the income taxation of elites to be sufficiently

---

(arguing that noncompliance by other taxpayers tends to decrease a taxpayer's tax morale and compliance).

164. HM TREASURY, EXCHANGE OF INFORMATION, *supra* note 149, at ¶ 3.4.

165. Michael Backhaus & Angelika Hellemann, *Sigmar Gabriel: Und Wir Sollten die Bürger Darüber Abstimmen Lassen* pt. 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; *see also supra* notes 149–150 and accompanying text.

166. Alm & Martinez-Vazquez, *supra* note 163, 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.

Draft: Do Not Cite

visible 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 collectively insist on meaningful representation.[167] 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.[168] On

---

167. 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. Aristide R. Zolberg, *Strategic Interactions and the Formation of Modern States: France and England*, 32 INT'L SOC. SCI. J. 687 (1980).

168. *See generally* 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 P.S.: POL. SCI. & POL. 24 (1991); 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) [hereinafter LEVI, OF RULE AND REVENUE]. *See also* DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE, AND ECONOMIC PERFORMANCE 49 (1990); Mancur Olson, *Dictatorship, Democracy, and Development*, 87 AM. POL. SCI. REV. 567 (1993); 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); CHARLES TILLY, COERCION, CAPITAL AND EUROPEAN STATES, AD 990–1990, at 96–114 (1990); 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; 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).

Draft: Do Not Cite

the other hand, some of these scholars suggest that external funding allowed third-world client regimes during 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.[169] 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.[170] 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.[171] Cross-border anonymous withholding obviates the need to strengthen governance institutions in order to collect revenue, as it presupposes collection and remittance by a foreign financial institution under the regulatory authority of a foreign sovereign. Furthermore, relying on foreign financial institutions for routine tax collection, rather than on domestic withholding, information reporting, and/or quasi-voluntary self-assessment, may reduce the capacity of compliant and visible taxpayers to bargain for law and representation in exchange for tax revenues.[172] In contrast, automatic information exchange may strengthen domestic governance

---

169. TILLY, *supra* note 168, at 207–22.

170. *See* Michael L. Ross, *Does Oil Hinder Democracy?*, 53 WORLD POL. 325 (2001); Hazem Beblawi, *The Rentier State in the Arab World*, *in* THE ARAB STATE 85–98 (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 130–55 (Ghassan Salamé ed., 1994); *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.

171. *See, e.g.*, 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; LEVI, OF RULE AND REVENUE, *supra* note 168.

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

Draft: Do Not Cite

institutions both by improving the capacity of domestic authorities to handle tax compliance and forcing an interaction between government and taxpayers in order for tax to be collected.[173]

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 society 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.[174] 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.[175] 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

---

173. 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.

174. For instance, if anonymous withholding were commonplace it would not be possible to accurately show what part of the income tax was paid by the top 1 percent of income earners. *See* Margaret Levi & Audrey Sacks, *Achieving Good Government—and, Maybe, Legitimacy* (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 a belief by the citizenry that the government is raising funds in an equitable manner in addition to serving the public good).

175. Against this background, concerns regarding the potential for instances of 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 112. Such concerns do, however, suggest the importance of safeguards to prevent and penalize misuse of taxpayer information. *See infra* notes 223–222.

Draft: Do Not Cite

"whoever is rich can buy themselves free from punishment."[176] 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.[177] Others suggest 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.[178] An automatic

---

176. Backhaus & Hellemann, *supra* note 165, at pt. 2.

177. *See, e.g.*, Maureen B. Cavanaugh, *Democracy, Equality, and Taxes*, 54 ALA. L. REV. 415 (2003); Bird & Zolt, *supra* note 19, 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"); *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 STRATEGY TO ACHIEVE MORE BROADLY SHARED GROWTH 7 (2008), *available at* http://www.brookings.edu/~/media/research/files/papers/2008/11/path%20to%20prosperity/11_path_to_prosperity; Kenneth M. Scheve & Matthew J. Slaughter, *A New Deal for Globalization*, 86 FOREIGN AFF., July–Aug. 2007, at 34.

178. *See* Bates & Lien, *supra* note 168; LEVI, OF RULE AND REVENUE, *supra* note 168. Niall Ferguson suggests that direct taxes on elites are positively associated with the growth of representative institutions. FERGUSON, *supra* note 168, 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

Draft: Do Not Cite

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.[179] 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.[180]

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 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.

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

---

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.").

179. *See generally* Levi & Sacks, *supra* note 174. In contrast, cross-border information reporting can provide a tool to preserve the role of the state as the ultimate enforcer of tax assessments.

180. *See generally* Bird, Martinez-Vazquez & Torgler, *supra* note 161.

Draft: Do Not Cite

that it will not adjust the applicable tax rates.[181] Furthermore, the treaties lock in a particular definition of income, dividends, other income, and capital gain that cannot be changed without bilateral agreement.[182] 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 law of the Partner Country. 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

---

181. U.K.-Switz. Cooperation Agreement, *supra* note 13, art. 20(2); Ger.-Switz. Cooperation Agreement, *supra* note 13, art. 19(2); Austria-Switz. Cooperation Agreement, *supra* note 4, art. 18(2). The United Kingdom, Germany, and Austria 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, U.K., or German law. U.K.-Switz. Cooperation Agreement, *supra* note 13, art. 20(2); Ger.-Switz. Cooperation Agreement, *supra* note 13, art. 19(2); Austria-Switz. Cooperation Agreement, *supra* note 4, art. 18(2). Under the agreements, Austria, the United Kingdom, and Germany 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 13, art. 44(3)-(4); Ger.-Switz. Cooperation Agreement, *supra* note 13, art. 43(3)-(4); Austria-Switz. Cooperation Agreement, *supra* note 4, art. 40(3)-(4). This is more flexible than the general termination rules under the agreement, 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 13, art. 44(2); Ger.-Switz. Cooperation Agreement, *supra* note 13, art 43(2); Austria-Switz. Cooperation Agreement, *supra* note 4, art. 40(2).

182. U.K.-Switz. Cooperation Agreement, *supra* note 13, art. 25–28; Ger.-Switz. Cooperation Agreement, *supra* note 13, art. 24–27; Austria-Switz. Cooperation Agreement, *supra* note 4, art. 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.

Draft: Do Not Cite

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 to (1) cede a measure of their ability to assert their taxing authority domestically over their residents, (2) consider Swiss reactions in the course of making domestic taxing decisions, and (3) 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 capital income of domestic residents. 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 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.[183] Further, permitting anonymous withholding is incompatible with maintaining a fully functional comprehensive

183. 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.

Draft: Do Not Cite

income tax with graduated rates.[184] 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.

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. However, as described in Part I, the fact that today only 6.5 percent of global wealth is managed offshore 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.[185] 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.[186] The concessions Switzerland extracted from Germany make it easier for wealthy Germans to bank exclusively through Swiss

---

184. 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 over-taxation 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.

185. BCG, GLOBAL WEALTH, *supra* note 1, at 12. Nor is Argentina 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.*

186. 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 to either create a subsidiary or branch in Germany or operate in partnership with an existing German financial institution, in order to legally serve German clients. *See* Press Release, Swiss Fed. Dep't of Fin., Switzerland and Germany Initial Tax Agreement, *supra* note 118.

Draft: Do Not Cite

institutions without the Swiss institution maintaining any German footprint.[187] Similar provisions are incorporated in the Swiss-Austrian agreement.[188] If, in exchange for anonymous withholding, offshore asset management jurisdictions were able to consistently extract concessions allowing them to legally compete with domestic financial institutions without having local footprints or being subject to local regulation, a further 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-

---

187. 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, BUNDESGESETZBLATT [BGBL.] 1522, 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 the obligation for Swiss institutions to initiate legal client relationships via a local German financial institution will be eliminated.

188. Austria-Switz. Cooperation Agreement, *supra* note 4, Memorandum on Procedural Aspects of Cross-Border Activities in the Financial Sector.

Draft: Do Not Cite

states. Furthermore, the proponents of an anonymous withholding system have no interest in its globalization. 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 also provide benefits to other tax administrations.

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 automatically collect tax 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.[189] Thus, in their agreements with Austria, the United Kingdom, and Germany, 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.[190] If anonymous withholding agreements are

---

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

190. 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." U.K.-Switz. Cooperation Agreement, *supra* note 13, Joint Declaration Concerning the Equivalence of this Agreement; Ger.-Switz. Cooperation Agreement, *supra* note 13,

Draft: Do Not Cite

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 further erode bank secrecy, 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.[191] 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.[192] It is important to recognize that for any large developed economy, anonymous withholding by Switzerland alone is unlikely to substantially deter tax evasion. High-quality wealth-management services are available in many jurisdictions. 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 a Swiss bank. The Swiss agreements state that Swiss banks will not "actively encourage" their current clients to use this strategy—a provision of questionable enforceability and relevance, given that the agreements both permit and anticipate the transfers. Swiss banks are allowed to facilitate these asset transfers on request from current customers, and to promote

---

Gemeinsame Erklärung der Vertragstaaten zur Gleichgewichtigkeit des Abkommens (Joint Declaration Concerning the Equivalence of this Agreement); Austria-Switz. Cooperation Agreement, *supra* note 4, Gemeinsame Erklärung der Vertragstaaten zur Gleichgewichtigkeit des Abkommens (Joint Declaration Concerning the Equivalence of this Agreement).

191. __.

192. 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* Ger.-Switz. Cooperation Agreement, *supra* note 13, art. 16; U.K.-Switz. Cooperation Agreement, *supra* note 13, art. 18; Austria-Switz. Cooperation Agreement, *supra* note 4, art. 15.

Draft: Do Not Cite

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.[193]

If Germany and the United Kingdom 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. 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 to accept 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.[194] Anonymous withholding agreements between those jurisdictions and Germany and the United Kingdom would make it easier for all asset management jurisdictions to agree to anonymous withholding for a limited set of powerful states, and to reject broadly multilateral automatic information exchange. To effectively support the development of a broadly multilateral automatic information exchange system, Germany and the United Kingdom probably need to affirmatively decide not to ratify (or terminate) their agreements with Switzerland.

Draft: Do Not Cite

---

193. Meanwhile Joint Statement II and FATCA withholding ensure a better-than-level playing field for Swiss financial institutions vis-á-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 5.

194. The Labor 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.

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. 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.[195] 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 tax 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),[196] the presumption against collecting revenue for other governments runs deep, both as a policy matter and as a legal matter.

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

---

195. *See* U.K.-Switz. Cooperation Agreement, *supra* note 13, art. 36; Ger.-Switz. Cooperation Agreement, *supra* note 13, art. 34; Austria-Switz. Cooperation Agreement, *supra* note 4, art. 31.

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

Draft- Do Not Cite

territorially limited state sovereignty.[197] 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 territory of the home state.[198] The default assumptions that stipulate appropriate behavior by a political entity in a given situation create a substantial presumption against collection assistance.[199] 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 through facilitation of extraterritorial exercise of taxing power within their territory. This fact explains why, although the OECD Model Tax Convention has included a model provision for assistance in collection in specific cases (assuming all necessary information can be provided by the residence country) since 2003, the official commentary describes the provision in realist terms.[200] The agreed commentary observes that during

---

197. *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.") (quoting Att'y Gen. of Canada v. R.J. Reynolds Tobacco Holdings, Inc., 268 F.3d 103, 119 (2d Cir. 2001)).

198. *See, e.g.*, U.N. Secretariat, Mutual Assistance in Collection of Tax Debts, Report of the 10th Meeting of the United Nations Ad Hoc Group of Experts on International Cooperation in Tax Matters, 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 (1994); Alan R. Johnson et al., *Reciprocal Enforcement of Tax Claims Through Tax Treaties*, 33 TAX LAW. 469, 469–70 (1980).

199. __.

200. The United Nations Model Double Taxation Convention between Developed and Developing Countries has no collection assistance provision, although the UN 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, Chief of the Int'l Tax Cooperation & Trade Section at the U.N. Fin. for Dev. Office, *The UN Model Tax Convention as Compared With the OECD*

Draft: Do Not Cite

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.[201] The OECD Model Commentary acknowledges that even when tax debts are fully determined by the 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.[202]

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.[203] Although it began as a common law doctrine,[204] the revenue rule is

---

Model Tax Convention—Current Points of Difference and Recent Developments, 15 ASIA-PAC. TAX BULL. 4, 10 (2009).

201. *Id.*

202. 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. FISCAL COMM., LEAGUE OF NATIONS, LONDON AND MEXICO MODEL TAX CONVENTIONS: COMMENTARY AND TEXT 100–01 (1946) (Model Bilateral Convention for the Establishment of Reciprocal Administrative Assistance for the Assessment and Collection of Direct Taxes: Mexico Draft; 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.

203. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 483 & reporter's note 1 (1987) (citing Holman v. Johnson, (1775) 98 Eng. Rep. 1120 (K.B.)) ("Courts in the United States are not required to recognize or to enforce judgments for the collection of taxes, fines, or penalties

Draft: Do Not Cite

sufficiently deeply entrenched as a default in both common law[205] and civil law jurisdictions that it is sometimes described as "the first and most fundamental rule of international tax law."[206]

---

rendered by the courts of other states."). 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).

204. 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.); s*ee, e.g.*, Ludlow v. Van Rensselaer, 1 Johns. 94 (N.Y. 1806) (defendant could not avoid enforcement of promissory note on the basis that 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).

205. *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.) 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 (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).

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

Draft: Do Not Cite

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.[207]

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. Those standards are also endorsed by the G8, the G20, the United Nations, and the OECD. They call for exchange of information on request where it is "foreseeably relevant" to the administration and enforcement of the domestic laws of the treaty partner, provided that the exchanged information is only used for legitimate tax administration purposes. There are no restrictions on exchange permitted on the basis of bank secrecy or domestic tax interest requirements.[208] A "high-level working panel" convened by the United

---

Assistance Can Overcome Limitations of the "Revenue Rule" (*Part 2*), 14 J. INT'L TAX'N 20 (Sept. 2003).

207. *See, e.g.*, Pasquantino v. United States, 544 U.S. 349, 350, 369–70 (2005) (providing that "at its core, [the revenue rule] prohibited the collection of tax obligations of foreign nations," and that "[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") (quoting Banco Nacional de Cuba, 376 U.S. at 448 (White, J., dissenting)).

208. *See, e.g.*, JEFFREY OWENS & PASCAL SAINT-AMANS, OECD, PROMOTING TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES: A BACKGROUND INFORMATION BRIEF 2 (2010); *Work on Exchange of Information and Conclusion*, U.N. E.S.C.O.R. 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 (2006); G8 Agreement From 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 ¶ 2, Oct. 15–16, 2005, *available at* http://www.mof.go.jp/english/international_policy/convention/g20/g20_051016.pdf; G7, *Economic Communiqué: Making a Success of Globalization for the Benefit of All* ¶ 16 (June 28,

Draft: Do Not Cite

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.[209]

The globally agreed 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. However, there is nothing in the standards that is conceptually limited to exchange upon request, 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 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.[210] The 2010 protocol made changes that (when integrated with the preexisting convention) make the Multilateral Convention a landmark agreement. The

---

1996), *available at http://*www.g7.utoronto.ca/summit/1995halifax/financial/index.html; OECD, THE GLOBAL FORUM ON TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES 2 (2011), *available at* http://www.oecd.org/tax/transparency/48981620.pdf. *See also*, *e.g.*, ORG. FOR ECON. COOPERATION & DEV., OVERVIEW OF THE OECD'S WORK ON COUNTERING INTERNATIONAL TAX EVASION, *supra* note 23; OECD, TAX CO-OPERATION 2010: TOWARDS A LEVEL PLAYING FIELD—ASSESSMENT BY THE GLOBAL FORUM ON TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES 9, 15 (2010). A "domestic tax interest requirement" is a domestic law rule that tax information can only be exchanged with another government if it is also relevant to the tax burden imposed on the taxpayer by the jurisdiction providing the information. *See also* OECD, *supra* note __ and accompanying text.

209. High-Level Int'l Intergovernmental Consideration of Fin. for Dev., Rep., transmitted by letter dated June 25, 2001 from the Secretary-General to the President of the General Assembly, U.N. GAOR, 55th Sess., Agenda Item 101, U.N. Doc. A/55/1000 (June 26, 2001), *available at* http://www.un.org/esa/ffd/a55-1000.pdf.

210. *See supra* notes 88–89 and accompanying text.

Draft: Do Not Cite

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." This aspect of the protocol indicates a shift in international norms toward multilateral automatic information exchange.[211] The Multilateral Convention opens the 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.[212]

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, and every G20 member had endorsed it.[213]

---

211. The protocol amends the convention so as to clarify that a request can be made without the name and address of a specific taxpayer. OECD, THE MULTILATERAL CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS: AMENDED BY THE 2010 PROTOCOL, (article III of the 2010 Protocol amends Article 18 of the Multilateral Convention). The Explanatory Report to the Convention goes on to explicitly 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 MATTERS22 (2010), *available at* http://www.oecd.org/ctp/exchangeofinformation/48091084.pdf. *See also* OECD, Update to Article 26 of the OECD Model Tax Convention and its Commentary, *supra* note 24. The changes to the Commentary to Article 26 of the OECD Model Convention agreed after the initial online release of this article move the Commentary to Article 26 in the direction of the Multilateral Convention's stance with respect to ascertainable group requests.

212. *See* OECD, *supra* note __, art. 6.

213. 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. *See* Council of Europe, *Status of the Convention on Mutual Administrative Assistance in Tax Matters and Amending Protocol*, COUNCIL OF EUR. (May 15, 2012),

Draft: Do Not Cite

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 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 OECD, EU, and U.S. approaches. Building such a system requires substantial agreement among participating countries about certain design features. The key dimensions of the OECD, EU, and U.S. systems that would need to be reconciled are routing,

---

http://conventions.coe.int/Treaty/Commun/ChercheSig.asp?NT=127&CM=1&DF=&CL=ENG (last visited June 19, 2012). The members of the G20 are Argentina, Australia, Brazil, Canada, China, the European Union, France, Germany, India, Indonesia, Italy, Japan, Mexico, the Republic of Korea, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom, and the United States. *Members*, G20, http://www.g20.org/index.php/en/members (last visited July 30, 2012). At the November 2011 G20 Summit, all G20 countries also noted that, "we will consider exchanging information automatically on a voluntary basis as appropriate and as provided for in the convention." G20, *Cannes Summit Final Declaration—"Building Our Common Future: Renewed Collective Action for the Benefit of All"*, G20, at ¶ 35 (Nov. 4, 2011), http://www.g20-g8.com/g8-g20/g20/english/for-the-press/news-releases/cannes-summit-final-declaration.1557.html (last visited June 19, 2012).

Draft: Do Not Cite

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.[214] However, Joint Statement I implies the need for such reconciliation, 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 not sufficient 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 information exchange system by considering certain design questions associated with routing, identification, reporting, verification, and incentives in a multilateral system.

---

214. 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 that, for example, 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, Treas. Reg. § 1.6049-1 et seq., 77 Fed. Reg. 23391 (2012), the U.S. Treasury has not yet provided regulatory guidance to this effect as a companion to its efforts under FATCA.

Draft: Do Not Cite

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 of the source of the income received by the taxpayer. 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. Information related to each other's resident taxpayers is then exchanged between EU governments through arrangements of reciprocity. Finally, under FATCA as legislated, 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.[215] 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 today.[216] The EUSD system thus avoids the conflict-of-

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

216. Indeed, it is required to have access to such information for tax information exchange purposes pursuant to the internationally agreed standards for tax information exchange upon request. *See* OECD, TERMS OF REFERENCE: TO MONITOR AND REVIEW PROGRESS TOWARDS TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES 6–7 (2010), *available at* http://www.oecd.org/dataoecd/37/42/44824681.pdf [hereinafter OECD, TERMS OF REFERENCE].

Draft: Do Not Cite

law issues associated with 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.[217] Likely for these reasons, Joint Statement I contemplates adopting the EU routing system for cooperating countries.[218]

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.[219] 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

---

217. To illustrate the point, imagine that in order to comply with FATCA, the IRS issued administrative guidance requiring financial institutions to provide the IRS information on the accounts of all non-resident 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. However, if such a system applied to nonresident accounts of all countries, 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 government of the asset-management country presumptively already could access that information today. For that reason alone, this system seems both the most fair 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.

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

219. *See supra* note 102 and accompanying text.

Draft: Do Not Cite

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

B. Identifying Taxpayers and Their Country 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.[220] 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 that treats taxpayers as residing wherever they resided at the time their most recent passport was issued.[221] 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

---

220. *Report by the Pilot Group on Improving Procedures for Tax Relief for Cross-Border Investors*, OECD (Feb. 8, 2010), *available at* http://www.oecd.org/dataoecd/20/36/44556378.pdf.

221. 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 have been ongoing since 2008, but the European Union has not yet reached unanimity on these matters. *See* COMMISSION OF THE EUROPEAN COMMUNITIES, PROPOSAL FOR A COUNCIL DIRECTIVE AMENDING DIRECTIVE 2003/48/EC ON TAXATION OF SAVINGS INCOME IN THE FORM OF INTEREST PAYMENTS 15–16 (2008), *available at* http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)727_en.pdf.

Draft: Do Not Cite

multilateral regime.[222] However, FATCA's rules for customer identification (as described in proposed Treasury regulations released on February 8, 2012) are highly prescriptive.[223]

In many cases involving financial institutions in cooperating jurisdictions, highly prescriptive rules may be costly to implement without providing any benefit to governments above and 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"). However, a more prescriptive system, with tougher customer identification rules, is appropriate where domestic regulatory oversight is absent and therefore does not provide an additional incentive to 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 process with cooperating governments. Indeed the model intergovernmental agreement, released after this Article had entered the editorial process, effectively permits financial instituions in Joint Statement I countries to use less onerous, more principles-based techniques developed for anti-money-laundering purposes in order to identify accountholders and the country of residence of their controlling persons.

---

222. 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.

223. Prop. Treas. Reg. § 1.1471-4, 77 Fed. Reg. 9029 (Feb. 8, 2012).

Draft: Do Not Cite

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.[224] The U.S. Treasury's decision with regards to income reporting conforms the basis for determining amount and character of income for FATCA reporting purposes to the European Union's Directive on Administrative Cooperation in the Field of Taxation.[225] However, if the FATCA regulations are viewed as a predecessor to a multilateral system, FATCA reporting guidelines also may represent the United States' 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. However, 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, the 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 international standards in this regard.[226]

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.

---

224. Prop. Treas. Reg. § 1.1471-4(d)(4), 77 Fed. Reg. 9029, 9032 (Feb. 8, 2012).

225. *See supra* note 80 and accompanying text.

226. Note, however, that the Joint Statement implies that FATCA Partner Countries will implement legislation to collect and report the information required under FATCA. Joint Statement I, *supra* note 4.

Draft: Do Not Cite

Further verification arguably becomes unnecessary.[227] The European Union sensibly relies on this principle, on 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 independent accounting firms to verify compliance in noncooperative jurisdictions would seem the most promising approach in the context of a system that has achieved broad multilateral acceptance.[228]

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." 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. 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 necessarily 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

227. A multilateral regime could also incorporate an explicit requirement that the enforcement mechanisms that apply to ensure domestic reporting also must be applied with respect to nonresident accounts.

228. 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.

Draft: Do Not Cite

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, Joint Statement I committed to "develop a practical and effective alternative approach to achieve the policy objectives of passthru payment withholding."[229]

Coercive measures are necessary to create a multilateral automatic information exchange system, but 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 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 similar 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 Swiss law to accommodate such reporting as the price of avoiding FATCA withholding.

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.

---

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

Draft: Do Not Cite

F. Addressing Concerns Regarding Potential Misuse of Information

One of the critical principles under today's 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.[230] Countries that do not abide by this standard are not entitled to 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 ongoing today. 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. A multilateral automatic information exchange system should both (1) enforce the existing Multilateral Convention's upfront requirement that governments have laws in place consistent with international standards to prevent the misuse of

---

230. 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, information 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 23, at 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 216, 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 112.

Draft: Do Not Cite

exchanged information and (2) provide for monitoring systems and credible sanctions over time (most notably, denial of information exchange or removal from the multilateral system) as part of the establishment of any multilateral automatic information exchange system.[231] Taking these two steps would both protect the 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 taxation cross-border to arguing about how they should act as tax agents for residence countries. This is 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 this 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 tax intermediaries cross-border.

Nevertheless, a great deal is at stake in the choices currently being made between partial anonymous withholding and a broadly available information reporting regime for administrative assistance cross-border. The choice between the two approaches is real even if it is a choice among the second-best and the consequences of choosing between the available alternatives

---

231. 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* OECD, REVISED METHODOLOGY FOR PEER REVIEWS AND NON MEMBER REVIEWS (2011), *available at* http://eoi-tax.org/keydocs/2e322d785ed58b73985d040598b1aea9.

Draft: Do Not Cite

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 OECD, the European Union, 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.

Draft: Do Not Cite